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## TRUST RECEIPT FINANCING UNDER THE UNIFORM TRUST RECEIPTS ACT

Warren A. Heindl\*

EVERY INCREASE in the production of goods, particularly in periods when money becomes scarce, leads to a stimulation of interest in methods of financing. Dealers in merchandise, especially those in retail fields, then become forced to resort to one or more of the varied devices known to business in order to acquire and maintain stocks of goods for resale. Among such devices, that known as the trust receipt was beginning to attain a deserved popularity prior to the recent war. There is every reason to presume that it will again become the vogue, perhaps even be more frequently used, as conditions return to a more normal base. One thing likely to check that development would be a hesitation born of ignorance and confusion over the legal and economic factors dictating the choice or rejection of that particular form of industrial financing.

Not even the drafting of a Uniform Trust Receipts Act,<sup>1</sup> promulgated in 1933, has operated to dispel that ignorance, while occasional articles and commentaries thereon<sup>2</sup> have not shed too

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<sup>1</sup> Unif. Laws Anno., Vol. 9, pp. 665 et seq.

<sup>2</sup> Notes and brief comments may be found in 4 Brooklyn L. Rev. 100, 41 Col. L. Rev. 1134, 4 Ford. L. Rev. 108, 32 Ill. B. J. 279, 12 N. Y. L. Q. 468, 15 Ore. L. Rev. 171, 9 St. Johns L. Rev. 250, 17 St. Johns L. Rev. 136, 16 Temp. L. Q. 208, 18 Temp. L. Q. 406, 82 U. of Pa. L. Rev. 270, 20 Va. L. Rev. 689, 29 Va. L. Rev. 650, and 45 Yale L. J. 1272. More comprehensive statements appear in Bogert, "The Effect of the Uniform Trust Receipts Act," 3 U. of Chi. L. Rev. 26 (1935);

much nor too complete a light on its operation. Pending proposals to compile a commercial code designed to modernize and correlate a number of uniform statutes dealing with commercial transactions<sup>3</sup> force the whole problem of the trust receipt into the foreground, for any such code must necessarily take that business device into account.<sup>4</sup> Unfortunately, the present statute has not had the seasoning granted to other uniform commercial measures,<sup>5</sup> has received less attention from the courts, and many of its provisions have yet to receive judicial consideration. Clarification and revision is undoubtedly needed,<sup>6</sup> hence the following discussion of what is and what is not permitted under the present law might serve to point out at least the most obvious defects.

### I. TRUST RECEIPTS AT COMMON LAW

Those who have never considered a trust receipt, as well as those who have but who feel a need for a renewal of acquaintance-ship, may reach some understanding of inherent problems through a short summary of fundamental usages and common-law origins. In the period when industry and commerce operated on a sole-proprietorship basis, inventories of goods, whether for manufacturing or resale purposes, were typically carried as wholly-owned goods or bought on open credit. With the development of large-scale industry, where open credit buying was not always feasible

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Djorup, "How to Use Trust Receipts Now," 30 J. of Am. Bank. 23 (1937); "Defense and Uniform Trust Receipts," 33 J. of Am. Bank. 42 (1941); "Uniform Trust Receipts Act," 33 J. of Am. Bank. 66 (1941); Djorup, "Aids in Financing War Goods," 34 J. of Am. Bank. 27 (1942); "Financing Coal Dealers," 34 J. of Am. Banking 54 (1942); "Auto Credit Safeguard," Bus. Week, Mar. 2, 1940, p. 24; Janousek, "The Advent of Trust Receipts," Commerce Rep., Sept. 24, 1938, p. 848; Janousek, "Trust Receipts in the Philippines," Commerce Rep., Dec. 3, 1938, p. 1075; "California Uniform Trust Receipts Law," Com. and Fin. Chron., Vol. 146, p. 2781 (1938); Layton, "Beware of Laws Called Uniform," Credit & Fin. Management, Vol. 40, p. 21 (1938); and Jacoby and Saulnier, "Financing Inventory on Field Warehouse Receipts," Nat. Bureau of Econ. Research, p. 11 (1944).

<sup>3</sup> Short discussions of the proposed Commercial Code, by W. L. Beers, appear in Bus. Lawyer, Vol. 2, p. 14, and Vol. 3, p. 12.

<sup>4</sup> See Bus. Lawyer, Vol. 3, p. 12 at p. 13.

<sup>5</sup> A table of dates of the enactment of the several statutes appears in Beers, "The New Commercial Code," 2 Bus. Lawyer 14.

<sup>6</sup> Speaking of the Uniform Trust Receipts Act, Judge McColloch, in the case of *In re Chappell*, 77 F. Supp. 573 at 575, said it was a "perplexing maze of technical phrases wholly incomprehensible without an extensive study of the background and development of the security device known as the trust receipt."

or desirable, utilization of security devices became necessary. At first, protection was afforded through the chattel mortgage<sup>7</sup> and the conditional sales agreement,<sup>8</sup> both of which, from the legal standpoint, provided adequate security combined with simplicity in theory and operation, but they met with disfavor on the part of businessmen and financiers; a disfavor growing from cumbersome features not geared to the tempo of modern business.

The chattel mortgage, for example, following the pattern of the real-estate mortgage, required notoriety for its effectiveness because of the existence of recording statutes, and, as the mortgagee held what was essentially only a security lien, forced upon the creditor an unwelcome compliance with formalities of foreclosure in case of default.<sup>9</sup> In addition, recording requirements were disadvantageous in cases where the credit advanced was on a short-term basis or where it was extended by a large scale business but covering many separate and distinct transactions. Not the least objectionable feature of the publicly-recorded chattel mortgage was the fact that the debtor on such secured credit, who would prefer to keep his financial status secret, especially to his competitors, was forced to disclose the intimate details of his credit operations.<sup>10</sup>

In much the same way, the conditional sale device, wherein title was reserved by the seller as security for the payment of the price, had its drawbacks. The necessity for judicial foreclosure in the case of default might depend upon the laws of the individual states, for there is a conflict in this regard.<sup>11</sup> Disadvantages of recording might still be present, for most states require it in the case of this type of security device also.<sup>12</sup> The principal objection to the conditional sale contract, however, lay in the fact that it

<sup>7</sup> A discussion of the title and lien theories of chattel mortgages may be found in Jones, *The Law of Chattel Mortgages and Conditional Sales* (The Bobbs-Merrill Co., Indianapolis, 1933), 6th Ed., § 1.

<sup>8</sup> *Ibid.*, § 925.

<sup>9</sup> *Ibid.*, § 713 et seq.

<sup>10</sup> 7 Harv. Bus. Rev. 357 at 359.

<sup>11</sup> Jones, *op. cit.*, §§ 1367-8.

<sup>12</sup> *Ibid.*, § 1008 et seq., lists the states requiring recording of conditional sales agreements.

could not be used with convenience where the financing was to be furnished by an individual other than the seller.<sup>13</sup>

Obviously, then, the ideal security device ought to contain the following features: (1) acquisition by the lender of the full legal title as security rather than some form of lien, thereby making foreclosure upon default unnecessary; (2) simplicity of procedure whereby sale and financing can be accomplished in one transaction, even though the financing be provided by someone other than the seller; and (3) obviation of the necessity for recording under the various state statutes, yet still affording sufficient notice so as not to unjustifiably deceive third persons.

The trust receipt was developed to fulfill the needs of business and to provide the aforementioned desirable attributes of a security device. The business methods utilized are relatively simple, but the legal problems engendered thereby are often technical and complicated. The typical transaction takes place as follows.<sup>14</sup> The prospective purchaser, designated as the trustee, orders goods from the seller, having previously arranged with a banking house or finance company, named the entruster, to advance the necessary funds. The purchaser may require financial assistance to the extent of the full purchase price or, as is more usually the case, for only eighty or ninety per-cent. of it; the balance he is to furnish himself and has already placed the same on deposit with the lending agency. The merchandise so ordered is then shipped under a bill of lading made out to the order of the seller and by him endorsed in blank, to which a draft for the purchase price has been attached. When these documents arrive, the financier honors the draft and acquires possession of the bill of lading. This is then turned over to the purchaser but only after he has executed two instruments: (1) a note in favor of the financier for the money advanced toward the purchase price of the property, and (2) a

<sup>13</sup> An attempt to pervert a conditional sales agreement to perform the functions properly met by a chattel mortgage was nullified in *Raymond v. Horan*, *Bailiff of Municipal Court*, 323 Ill. App. 120, 55 N. E. (2d) 99 (1944), noted in 23 CHICAGO-KENT LAW REVIEW 58-9.

<sup>14</sup> A domestic transaction is adequately illustrated by the case of *In re James, Inc.*, 30 F. (2d) 555 (1929). For use of trust receipts in financing the importation of goods, see *Assets Realization Co. v. Sovereign Bank of Canada*, 210 F. 156 (1914).

trust receipt by which he acknowledges that the property being turned over to him belongs to the financier and under which he agrees to hold it in trust and according to the tenor of the instrument. As a general rule, the trust receipt provides that the property taken thereunder can be sold, warehoused, or manufactured and then sold, the proceeds of sale being applied to the debt. Once having possession of the bill of lading, the purchaser can obtain the goods from the carrier and utilize them in the manner set forth in the trust receipt.

Without attempting to analyze the foregoing transaction exhaustively,<sup>15</sup> it is obvious that its main purpose is to lodge title in the financier as security for the funds advanced, while permitting the purchaser to obtain possession of the goods with the privilege of sale.<sup>16</sup> This gives him an opportunity to realize any surplus as a profit for himself yet at the same time makes it possible to obtain funds with which to liquidate the debt evidenced by the note. The courts have recognized that this is the essential legal effect of the transaction for the title acquired by the financier-entruster is not defeated by transfer of possession to the purchaser-trustee, since that individual acknowledges, in the trust receipt, that title shall remain in the bank or credit company.<sup>17</sup>

The relationship between the parties to such a transaction must be considered not only (1) from the standpoint of the debt owed by the purchaser to the financier, but also (2) with regard to the security itself. As to the former, the note which the trustee executes creates an obligation upon which he is bound without reference to the security in his possession,<sup>18</sup> for that property is

<sup>15</sup> A more complete analysis may be found in Frederick, "The Trust Receipt as Security," 22 Col. L. Rev. 395 (1922); Hanna, "Trust Receipts," 29 Col. L. Rev. 545 (1929); Vold, "Trust Receipts in Financing of Sales," 15 Corn. L. Q. 543 (1929).

<sup>16</sup> *Carter v. Arguimbau*, 31 Abb. N. C. (N. Y.) 3 (1884); *English Bank v. Barr*, 31 Abb. N. C. (N. Y.) 7 (1888).

<sup>17</sup> *Century Throwing Co. v. Muller*, 197 F. 252 (1912). The court, in *In re Reboulin Fils & Co.*, 165 F. 245 at 248 (1908), said: "But an examination of the trust receipts discloses no intention on the part of the petitioners to waive or surrender their property in the goods, but rather a clear intention to retain such property, which intention, moreover, was fully acquiesced in. . . ."

<sup>18</sup> Even if the goods are retaken and sold by the financier upon default, the trustee is still responsible for any deficiency: *Charavay & Bodvin v. York Silk Mfg. Co.*, 170 F. 819 (1909).

held at his own risk,<sup>19</sup> and the destruction thereof, or conversion by a third party, will not release him from the debt.<sup>20</sup> The usual obligations of the ordinary credit transaction, therefore, are retained in full force and effect. As to the latter aspect, the rights and duties of the parties concerning the security itself are governed either by the trust receipt<sup>21</sup> or by the very nature of the transaction. Therefore, while the trust receipt seldom, if ever, provides that the financier's title may be defeated by payment of the obligation, the courts have suggested that this should be the effect, since he retains his interest in the property only for security purposes.<sup>22</sup> Besides having the right to eventually acquire title to the property, one other tangible benefit which the trustee obtains is that of having actual possession of the goods. This, however, is limited and subject to the usual provision that the holder of the trust receipt may repossess the property at any time.<sup>23</sup> Since the very intent of the trust receipt agreement is to preserve the security interest of the financier in the items turned over to the trustee,<sup>24</sup> it is understandable that the former will demand the observance of many duties by the latter with respect to the merchandise. Among the more important of these duties are obligations on the trustee's part (1) to pay all taxes and other expenses

<sup>19</sup> The rule that risk follows title may be abrogated by agreement and this is usually provided for in the form of the trust receipt. See form used in the case of *General Motors Acceptance Corp. v. Mayberry*, 195 N. C. 508, 142 S. E. 767 (1928).

<sup>20</sup> *C. I. T. Corporation v. Hawley*, 34 Cal. App. (2d) 66, 93 P. (2d) 216 (1939).

<sup>21</sup> In *General Motors Acceptance Corp. v. Dunn Motors*, 172 Ga. 400 at 402, 157 S. E. 627 at 628 (1931), the court said: "They solemnly agreed, and their agreement is evidenced by this trust receipt, that the motor vehicles are the property of General Motors Acceptance Corp. They made this acknowledgement for a valuable consideration; and as between the two parties, the party that advanced the money, and the party that received it and used it, the latter is bound by the acknowledgement and agreement."

<sup>22</sup> There are no cases directly in point, but see opinions in *Vaughan v. Massachusetts Hide Corporation*, 209 F. 667 (1913), *Smith v. Commercial Credit Corporation*, 113 N. J. Eq. 12, 165 A. 637 (1933), and *Mershon v. Wheeler*, 76 Wis. 502, 45 N. W. 95 (1890).

<sup>23</sup> See, for example, trust receipt form used in *In re Cattus*, 183 F. 733 (1910). For decisions upholding the right to repossess, see *Industrial Finance Corp. v. Turner*, 215 Ala. 460, 110 S. 904 (1927), *Scott v. Industrial Finance Corp.*, 265 S. W. (Tex. Civ. App.) 181 (1924), and *Shield Co. v. Cartwright*, 172 S. W. (2d) 108 (Tex. Civ. App., 1943).

<sup>24</sup> Most trust receipts contain the statement that the "intention of said agreement is to protect, and preserve unimpaired, the title of. . . ." See form used in *In re A. E. Fountain, Inc.*, 282 F. 816 (1922).

which may accrue against the security;<sup>25</sup> (2) to provide insurance for the property;<sup>26</sup> (3) to keep the goods identifiable and separate from those of the trustee;<sup>27</sup> (4) to refrain from encumbering the property with liens, chattel mortgages or the like;<sup>28</sup> and lastly, (5) to turn over, in kind, any proceeds of sale for application on the secured debt.<sup>29</sup>

As the trust receipt was seldom recorded, disputes over its validity as against third persons quite naturally arose. Considerable litigation developed between the financier and third persons such as purchasers, mortgagees, pledgees and creditors of the trustee; all of whom, believing that the trust-receipt property belonged to the trustee, attempted to acquire some form of interest therein. It was contended, in behalf of the latter, that as the entruster had failed to give notice of his secret lien, he should not be allowed to maintain his title against persons acquiring some subsequent interest. The answer varied with the jurisdiction. Some courts determined that filing requirements were applicable, as the trust receipt corresponded to a chattel mortgage,<sup>30</sup> a device in the nature of one,<sup>31</sup> or a conditional sale.<sup>32</sup> Other courts held

<sup>25</sup> A typical provision may be observed in the form used in *Associate Discount Corporation v. C. E. Fay Co.*, 307 Mass. 577, 30 N. E. (2d) 876 (1941). Pursuant thereto, it was held in *T. D. Downing Co. v. Shawmut Corporation*, 245 Mass. 106, 139 N. E. 525 (1923), that the financier was not liable for import duties.

<sup>26</sup> See form used in *Associate Discount Corporation v. C. E. Fay Co.*, 307 Mass. 577, 30 N. E. (2d) 876 (1941).

<sup>27</sup> *Ibid.* Violation of this agreement, according to *Peoples' Nat. Bank v. Mulholland*, 228 Mass. 152, 117 N. E. 46 (1917), may entitle the financier to all of the property pursuant to the doctrine of confusion as applied to personal property.

<sup>28</sup> See form used in case mentioned in note 26, ante.

<sup>29</sup> *Ibid.*

<sup>30</sup> *Commercial Inv. Trust Corporation v. Wilson*, 58 F. (2d) 910 (1932); *General Motors Acceptance Corp. v. Sharp M. Sales Co.*, 233 Ky. 290, 25 S. W. (2d) 405 (1930); *First Nat. Bank of Ocean City v. Eastern Motor Co.*, 109 N. J. L. 372, 162 A. 660 (1932); *Commonwealth Finance Corporation v. Schutt*, 97 N. J. L. 225, 116 A. 722 (1922); *General Contract Purchase Corporation v. Bickert*, 10 N. J. Misc. 958, 161 A. 830 (1932); *Garris v. Commercial Credit Co.*, 149 S. C. 498, 147 S. E. 601 (1929).

<sup>31</sup> *C. I. T. Corporation v. Seaney*, 53 Ariz. 72, 85 P. (2d) 713 (1938); *In re Williams*, 287 Mich. 689, 284 N. W. 609 (1939); *Carrolton Acceptance Co. v. Wharton*, 22 S. W. (2d) 985 (Tex. Civ. App., 1930); *General Motors Acceptance Co. v. Boddeker*, 274 S. W. 1016 (Tex. Civ. App., 1925).

<sup>32</sup> *Peoples' Loan & Investment Co. v. Universal Credit Co.*, 75 F. (2d) 545 (1935); *Pacific Finance Corporation v. Hendley*, 103 Cal. App. 335, 284 P. 736 (1930); *General Motors Acceptance Corp. v. Mayberry*, 195 N. C. 508, 142 S. E. 767 (1928); *Ahrens Refrigerator Co. v. R. H. Williams Co.*, 176 Okla. 5, 54 P. (2d) 200 (1936); *Commonwealth v. Williams*, 93 Pa. Super. 92 (1928).



that while there might be a difference between the trust receipt and other security devices, still the general recording act of the particular state was broad enough to apply.<sup>33</sup> In such jurisdictions, failure to record rendered the security title of the financier invalid against such third parties.<sup>34</sup>

But the same problem received different treatment in other states where the courts held that there was an intrinsic difference between the trust receipt and a chattel mortgage or a conditional sales agreement. That distinction was predicated on the fact that a trust receipt transaction required three parties for its consummation whereas the other security devices involved but two; moreover, as between a trust receipt and a chattel mortgage, the financier obtained his interest from the seller rather than from the debtor who never did have title. The fact that the debtor had possession of property in which a hidden title rested in a third party was deemed not to be as conducive of fraud upon creditors as would have been the case under an unrecorded chattel mortgage.<sup>35</sup> Similarly, the tri-partite feature took the trust receipt from the class of conditional sales as the individual holding title could not be considered a seller in the technical sense; he merely financed the transaction.<sup>36</sup> In these jurisdictions, therefore, recordation was regarded as unnecessary, and the courts consistently

<sup>33</sup> *In re Bettman-Johnson Co.*, 250 F. 657 (1918); *In re Richheimer*, 221 F. 16 (1915), cert. den. 238 U. S. 624, 35 S. Ct. 662, 59 L. Ed. 1494 (1915).

<sup>34</sup> *Commercial Acceptance Trust v. Bailey*, 87 Cal. App. 117, 261 P. 743 (1927); *Auburn Co. v. Namor Corporation*, 112 Fla. 89, 149 S. 801 (1933); *Maxwell Motor S. Corp. v. Bankers Mortgage & S. Co.*, 195 Iowa 384, 192 N. W. 19 (1923); *Motors Bankers Corporation v. C. I. T. Corporation*, 258 Mich. 301, 241 N. W. 911 (1932); *Karkuff v. Mutual Securities Co.*, 108 N. J. Eq. 128, 148 A. 159 (1928); *Dennistown v. Barr*, 31 Abb. N. C. 21, 28 N. Y. S. 255 (1893); *General Motors Corp. v. Seattle Ass'n, etc.*, 190 Wash. 284, 67 P. (2d) 882 (1937).

<sup>35</sup> *In re Otto-Johnson Mercantile Co.*, 52 F. (2d) 678 (1928); *Armstrong v. Greenwich Motor Corporation*, 116 Conn. 487, 165 A. 598 (1933); *Walton v. Commercial Credit Co.*, 68 S. D. 151, 299 N. W. 300 (1941); *Commercial Credit Co. v. Schleger-Storseth Motor Co.*, 23 S. W. (2d) 702 (Tex. Comm. App., 1930); *Ivy v. Commercial Credit Co.*, 173 Wash. 360, 23 P. (2d) 19 (1933).

<sup>36</sup> *In re Bell Motor Co.*, 45 F. (2d) 19 (1930), cert. den. 283 U. S. 832, 51 S. Ct. 365, 75 L. Ed. 1445 (1931); *Charavay & Bodvin v. York Silk Mfg. Co.*, 170 F. 819 (1909).

upheld the unrecorded trust receipt against trustees in bankruptcy<sup>37</sup> as well as other creditors of the trustee.<sup>38</sup>

Even in those states where an unrecorded tri-partite trust receipt transaction was deemed valid as against creditors, the courts nevertheless reached different conclusions regarding other third parties who had attempted to acquire an interest in the trust-receipt property upon the giving of actual value. Where a bona-fide purchaser bought the goods from the trustee, the decisions were unanimously in his favor, the courts holding that by allowing the trustee to have possession with an actual or an implied power to sell, the financier should be estopped to assert his title.<sup>39</sup> It has been noted that one of the express duties of the trustee was not to mortgage or pledge the property. Serious questions have arisen as to the status of an individual giving value and taking an interest by way of mortgage or pledge. Here, however, the decisions were divided, some courts holding that as no express nor implied power to pledge or mortgage existed there could be no basis for an estoppel;<sup>40</sup> but opposite conclusions have been reached on the basis of Factors' Acts<sup>41</sup> or the Bills of Lading Act.<sup>42</sup>

As the trust receipt became popular, attempts were made to divorce it from its tri-partite feature. Each, however, was thwarted

<sup>37</sup> *General Motors Acceptance Corporation v. Kline*, 78 F. (2d) 618 (1935); *Hamilton Nat. Bank v. McCallum*, 58 F. (2d) 912 (1932); *Houck v. General Motors Acceptance Corporation*, 44 F. (2d) 410 (1930); *In re James, Inc.*, 30 F. (2d) 555 (1929), reversing 30 F. (2d) 551 (1927); *In re K. Marks & Co.*, 222 F. 52 (1915); *Century Throwing Co. v. Muller*, 197 F. 252 (1912); *In re Cattus*, 183 F. 733 (1910); *In re Coe*, 183 F. 745 (1910); *Charavay & Bodvin v. York Silk Mfg. Co.*, 170 F. 819 (1909); *In re E. Reboulin Fils & Co.*, 165 F. 245 (1908); *Armstrong v. Greenwich Motor Corporation*, 116 Conn. 487, 165 A. 598 (1933); *Walton v. Commercial Credit Co.*, 68 S. D. 151, 299 N. W. 300 (1941).

<sup>38</sup> *Moors v. Wyman*, 146 Mass. 60, 15 N. E. 104 (1888); *Brown v. Billington*, 163 Pa. 76, 29 A. 904 (1894); *Mershon v. Wheeler*, 76 Wis. 502, 45 N. W. 95 (1890).

<sup>39</sup> *Handy v. C. I. T. Corp.*, 291 Mass. 157, 197 N. E. 64 (1935); *Clark v. Flynn*, 120 Misc. 474, 199 N. Y. S. 583 (1923); *Jones v. Commercial Investment Trust*, 64 Utah 151, 228 P. 896 (1924). See also *Glass v. Continental Guaranty Corporation*, 81 Fla. 687, 88 S. 876 (1921).

<sup>40</sup> *Tropical State Bank v. Sunshine Motor Co.*, 137 Fla. 703, 188 S. 595 (1939); *Globe Securities Co. v. Gardner Motors Co.*, 337 Mo. 177, 85 S. W. (2d) 561 (1935); *Moors v. Kidder*, 106 N. Y. 32, 12 N. E. 818 (1887). But see contra, *Monroe v. Philadelphia Warehouse Co.*, 75 F. 545 (1896).

<sup>41</sup> *Blydenstein v. New York Secur. & T. Co.*, 67 F. 469 (1905); *Industrial Trust Co. v. Webster Nat. Bank*, 258 Mass. 17, 154 N. E. 330 (1926).

<sup>42</sup> *Roland M. Baker Co. v. Brown*, 214 Mass. 196, 100 N. E. 1025 (1913).

by the courts, it being consistently held that three parties were necessary for a true trust receipt transaction. Thus, if the owner of personal property sold it and gave possession to the buyer under a trust receipt, reserving to himself a security interest, the courts classed this arrangement as a conditional sale.<sup>43</sup> Similarly, if an individual borrowing money executed a trust receipt giving as security a property right in goods he already owned, that transaction was treated as a chattel mortgage.<sup>44</sup> As to pledged property retaken under a trust receipt, there was a divergence of opinion, one court deciding that the pledgee's interest was lost and could not prevail as against creditors of the trustee,<sup>45</sup> while another held that the trust receipt preserved the pledgee's interest even though the pledgee was out of possession.<sup>46</sup>

Even where the tri-partite feature was present, the transaction would be scrutinized closely to see if the business procedure was such that title to the merchandise actually did pass to the financier from the seller. If the bills of lading were made out directly to the financier, title passed to him.<sup>47</sup> He likewise acquired title if they were made out to the order of the seller, were endorsed in blank, and then delivered to him.<sup>48</sup> If, however, the bills of lading were made out to the trustee so that ownership lodged in him, the financier's interest was treated as being obtained in such a way as to result in a chattel mortgage,<sup>49</sup> which would probably fail for non-observance of technical requirements attaching to that device.

This summary of common-law doctrines serves to illustrate the need which existed in a confused and conflicting field of law.

<sup>43</sup> *In re Ford-Rennie Leather Co.*, 2 F. (2d) 750 (1924); *Townsend v. Ashpool Fertilizer Co.*, 212 F. 97 (1914); *White v. General Motors Acceptance Corporation*, 2 F. Supp. 406 (1932).

<sup>44</sup> *In re A. E. Fountain, Inc.*, 282 F. 816 (1922); *Universal Credit Co. v. Gasow-Howard Motor Co.*, 73 S. W. (2d) 909 (Tex. Civ. App., 1934); *Texas Bank Y. & T. Co. v. Teich*, 283 S. W. 552 (Tex. Civ. App., 1926).

<sup>45</sup> *Arena v. Bank of Italy*, 194 Cal. 195, 228 P. 441 (1924).

<sup>46</sup> *In re Breuil & Co.*, 205 F. 573 (1913). See also *Canal-Commercial T. & S. Bk. v. New Orleans, etc., R. Co.*, 161 La. 1051, 109 S. 834 (1926).

<sup>47</sup> *Assets Realization Co. v. Sovereign Bank of Canada*, 210 F. 156 (1914).

<sup>48</sup> *In re James, Inc.*, 30 F. (2d) 555 (1929).

<sup>49</sup> *In re Draughn & Steele Motor Co.*, 49 F. (2d) 636 (1931); *In re Schuttig*, 1 F. (2d) 443 (1924); *Hartford Accident & Indemnity Co. v. Callahan*, 271 Mass. 556, 171 N. E. 820 (1930). Contra: *In re E. Reboulin Fils & Co.*, 165 F. 245 (1908), but note that some of the bills of lading there involved were made out directly to the dealer.

To answer that need, the Commissioners of Uniform Laws, in 1933, presented to the various state legislatures a set of rules designed to govern trust receipt transactions, now commonly referred to as the Uniform Trust Receipts Act. Twenty-one states have seen fit to enact these provisions into law albeit with some amendment and modification;<sup>50</sup> the remainder preferring, for the time being, to operate under the common-law principles above set forth. In the interest of comprehension, it is proposed, in the following discussion, to present a complete analysis of each provision of the uniform act and of the pertinent decisions thereunder as well as of the more significant modifications which have been adopted. The arrangement will follow the general outline of the Act, with only such minor deviations as may be desirable for purpose of clarity.

## II. TRUST RECEIPTS UNDER UNIFORM ACT

### A. CREATION OF RELATIONSHIP

The Uniform Trust Receipts Act, while it serves to modify some of the formalistic rules pertaining to trust receipts and also permits of their use in certain instances not recognized at common law, does not alter the basic functions of this type of security device for the only purpose of the trust receipt still is to permit one individual to have actual possession of property while another retains an interest therein. The party having possession is, by the statute, designated as the "trustee,"<sup>51</sup> while the one possessing

<sup>50</sup> Deering Cal. Civ. Code 1941, §§ 3012-16; Conn. Gen. Stat., 1939 Supp., Ch. 230a; Ida. Laws 1945, Ch. 73; Ill. Rev. Stat. 1947, Ch. 121½, § 166 et seq.; Burn's Ind. Stat. Anno. 1933, § 51-601; Md. Anno. Code, 1943 Supp., Art. 95½; Mass. Anno. Laws, Ch. 255A; Minn. Stat. Anno., Ch. 522; Mont. Laws 1945, Ch. 147; Nev. Comp. Laws, 1941 Supp., § 7719; N. H. Rev. Laws 1942, Ch. 263; N. J. Stat. Anno., Tit. 46, Ch. 35; McKinney's Cons. Laws of N. Y., Pers. Prop. Law, Art. 3-A; N. D. Laws 1945, Ch. 320; Ore. Comp. Laws Anno., Tit. 75; Purdon's Pa. Stat. Anno., Tit. 68, Ch. 15; S. D. Laws 1945, Ch. 169; Williams' Tenn. Code Anno., § 7792; Utah Code Anno. 1943, Tit. 81A; Va. Code Anno. 1942, 1946 Cum. Supp., § 3848 (70); Rem. Wash. Rev. Stat., 1943 Supp., Tit. 82-B, § 11548-30.

<sup>51</sup> Uniform Trust Receipts Act, § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(14). The term also includes any party succeeding to that individual's interest. The term "trustee" should not be confused with the term used in equity jurisprudence for the party taking possession of the property, while called a trustee, is not one in the technical sense of the word as he does not acquire a legal title which he holds for the benefit of a beneficiary. See *In re Cullen*, 282 F. 902 (1922), and *Frederick*, "The Trust Receipt as Security," 22 Col. L. Rev. 395 at 399. (*Editor's Note*: In the interest of brevity, the abbreviation UTRA will hereafter be used in conjunction with this article for the fuller phrase "Uniform Trust Receipts Act.")

the property interest is referred to as the "entruster."<sup>52</sup> It is not, however, every type of possession in the former nor every type of interest in the latter which will satisfy the requirements of the Act. There are limitations pertaining to each.

Only certain classes of property may be held by a trustee under a trust receipt, to-wit: goods, documents, and instruments.<sup>53</sup> The first of these terms has reference to any tangible personal chattels except such as may have become annexed to realty<sup>54</sup> and is sufficiently broad to cover raw materials, manufactured goods, or any intermediate product. The term "document" is intended to refer to "any document of title to goods,"<sup>55</sup> so the trustee may not only obtain possession of the goods themselves but also of any document representing such goods as, for example, a bill of lading or a warehouse receipt. Thus, if property is stored or in the hands of a carrier it can still be made the basis of a trust receipt transaction. The term "instrument," on the other hand, covers a wide variety of commercial paper including instruments as so defined by the Uniform Negotiable Instruments Act and also stocks, bonds, debentures or other paper customarily exchanged in the ordinary course of business.<sup>56</sup>

Mere possession of any of the above items does not necessarily signify a trust receipt transaction, for the trustee must have acquired the property for one of the limited and specified purposes provided in the Act. If possession is given for other reasons, the arrangement is not a trust receipt transaction.<sup>57</sup> In the case of the first two classes, possession is permitted in order that the trustee might sell or exchange the goods or documents, procure their sale or exchange,<sup>58</sup> or deal with the items in such manner as

<sup>52</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(3). The term also includes any successor in interest.

<sup>53</sup> UTRA § 2-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(a).

<sup>54</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(4). The definition of the term excludes choses in action and money.

<sup>55</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(2).

<sup>56</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(5). The term does not include document of title.

<sup>57</sup> UTRA § 2-3; Ill. Rev. Stat. 1947, Ch. 121½, § 167(3).

<sup>58</sup> UTRA § 2-3(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(a).

to prepare them for an eventual sale, as by having the goods processed, manufactured, loaded and shipped, or unloaded and stored.<sup>59</sup> While instruments may be released under a trust receipt for sale, exchange, or the procuring of such,<sup>60</sup> they may also be turned over for purpose of delivery, depositing, registering, presentment, collection, or renewal.<sup>61</sup>

Conversely, a trustee's possession of any of the designated property, even if for the purposes prescribed by the Act, is not alone sufficient for the entruster must have a property interest in these items, although it is not necessary that he be the owner. On the contrary, the Act is explicit in specifying that the latter's property right is to be for security only so ordinary bailments and consignments, where possession is acquired by the bailee or consignee but full title is retained by the bailor or consignor, do not amount to trust receipt transactions.<sup>62</sup> That "security interest," in turn, has been defined as any property interest acquired by the entruster for the purpose of securing the performance of an obligation.<sup>63</sup> There is no attempt made in the statute to catalog this interest in accordance with any common-law scheme of classification, but it is clear that as long as some kind of an interest is held for the purpose of securing some type of obligation it will fall within the provision, whether it be full ownership, a security title, or merely a pledgee's interest.<sup>64</sup>

In the acquisition of that security interest the entruster must, however, have given new value<sup>65</sup> which is defined as including new

<sup>59</sup> UTRA § 2-3(b); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(b).

<sup>60</sup> UTRA § 2-3(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(a).

<sup>61</sup> UTRA § 2-3(c); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(c).

<sup>62</sup> UTRA § 15; Ill. Rev. Stat. 1947, Ch. 121½, § 180.

<sup>63</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(12). The obligation may be owed by the trustee or by some third party.

<sup>64</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(12). Prior to the statute, courts were not in harmony as to the type of interest held by the entruster. Some felt he had full legal title, others merely a security title. The more enlightened treated it as a special type of ownership not comprehended by any common-law term. A discussion of the problem may be found in *In re Bettman-Johnson Co.*, 250 F. 657 (1918); *In re Richheimer*, 221 F. 16 (1915), cert. den. 238 U. S. 642, 35 S. Ct. 662, 59 L. Ed. 1494 (1915); and in Frederick, "The Trust Receipt as Security," 22 Col. L. Rev. 395 at p. 399 et seq.

<sup>65</sup> UTRA §§ 2-1(a) and 2-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1), subsections (a), (b) and (c).

loans or advances, the incurring of a new obligation, the release of a prior security interest which is still enforceable,<sup>66</sup> or the relinquishing of a claim to the proceeds of property which formed the basis of a prior trust receipt transaction.<sup>67</sup> Obviously, then, the consideration passing between the entruster and trustee must be a present one, so no valid security interest in trust receipt property can be based on a past indebtedness or pre-existing claim,<sup>68</sup> nor would the extension or renewal of such an obligation be sufficient as it is not possible to substitute a secured obligation for an existing unsecured one.<sup>69</sup> In much the same manner, once property is held under a trust receipt, obligations thereafter created or additional advances made cannot be secured by it.<sup>70</sup> There is reason to believe, however, that if at the time the parties entered into the original transaction they also entered into a binding commitment that future advances were to be made such advances, when made, could be secured by the trust receipt property.<sup>71</sup> There is one exception and that is where the entruster's security interest partakes of the nature of a pledgee's interest acquired before the trust receipt transaction was entered into. If such pledged property be released under a trust receipt, the surrender may be deemed some form of equivalent for new value whether the property was originally pledged to secure an old debt or for a new loan.

It is apparent, then, that the trust receipt transaction under the statute is not confined to one type of dealing but may be utilized

<sup>66</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(7).

<sup>67</sup> As the Act gives the entruster the right to the proceeds of property in which he has a security interest, UTRA § 10, Ill. Rev. Stat. 1947, Ch. 121½, § 175, the release or surrender of such a right is considered the giving of new value.

<sup>68</sup> UTRA § 14; Ill. Rev. Stat. 1947, Ch. 121½, § 179.

<sup>69</sup> See definition of "new value" set forth in UTRA § 1. Under the Illinois statute, however, such a renewal or extension is considered to be the giving of new value: Ill. Rev. Stat. 1947, Ch. 121½, § 166(7).

<sup>70</sup> UTRA § 14 states: "... nor shall the obligation secured under any trust receipt transaction extend to obligations of the trustee to be subsequently created." See also Ill. Rev. Stat. 1947, Ch. 121½, § 179.

<sup>71</sup> UTRA § 14 also declares that the property may be security for "... any new value given or agreed to be given as part of such transaction." Italics added. It would behoove both parties to make certain that the new advances originally made are sufficient to fulfill the needs of the trustee or else to execute a specific agreement that additional loans may later be made, using the same property as collateral. Unless this is done, the trustee might find himself in a position where more money is necessary or would be beneficial but cannot be obtained as the only collateral security he can give, is already held subject to a trust receipt.

in two separate and distinct ways: either (1) for the financing of purchases of goods where possession of the property is delivered to the trustee while the entruster retains a security interest therein, or (2) where property once pledged is returned to the pledgor under circumstances which would, at common law, have defeated the pledgee's rights. These differing usages call for distinct treatment.

### *1. The Trust Receipt as a Financing Device*

Consideration of the trust receipt as a financing device first requires a determination of the type or types of businessmen entitled to utilize it. The class of persons who may become trustees is easily discernible if reference is made to the purposes for which possession of property may be obtained under a trust receipt. It has already been indicated that, at least with regard to goods and documents, such purpose contemplates an acquisition for eventual resale so the ordinary consumer appears definitely excluded, thereby limiting the class of trustees to dealers, manufacturers, jobbers, and the like. In much the same way, the definition of an entruster specifically excludes an individual who sells merchandise on credit, retaining title to the property under a conditional sales contract or an interest therein by way of purchase-money mortgage.<sup>72</sup> It is, then, self-evident that no seller can ever become an entruster with reference to the property he sells, so the class of entrusters is narrowed to third persons not interested in selling for profit but rather only in the business of providing financing for purchases being made from others. In theory, any one other than the seller of property could become an entruster but for all practical purposes, particularly since this type of financing is apt to require large sums of capital, the entruster will usually be either a bank or some other corporation dealing in commercial credit.

<sup>72</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(3). The express exclusion of conditional vendors and purchase money mortgagees shows specifically that the drafters of the Act intended that the trust receipt should be treated as a distinct type of security device not to be associated with or confused by doctrines relating to either the mortgage or the conditional sale. In those states which have enacted the Uniform Act, therefore, it should no longer be possible for courts to confuse this newer device with the older forms.



In any discussion of the use of a trust receipt to finance purchases, the word "purchases" is used in its ordinary sense, *i.e.* as denoting newly acquired property in contrast to old stocks or inventories already in the possession of the trustee. Prior to the statute, courts confined trust receipt financing to the acquisition of new property, considering that if it was used to refinance old inventories it would be likely to serve as a fraud upon creditors of the trustee and upon other third parties. They, having prior dealings with the owner and knowing him to be such, would have been unduly imposed upon if, subsequently, another person was permitted to acquire an interest in the inventory while allowing possession thereof to be retained by the apparent owner without giving notice of the secret lien.<sup>73</sup> The framers of the present Act have taken the same position and actually intended that the device authorized by the statute was to be employed solely in financing newly acquired property.<sup>74</sup> No one, therefore, could be misled for the trustee, obtaining possession subject to the security interest, had never been an owner. Unfortunately, the Act does not declare that trust receipt financing is to be confined for use with this type of property and, as will be seen later, this represents one of its greatest failings. Keeping in mind the foregoing general principles applicable to the two types of financing transactions recognized by the Act, the first where the purchaser ordering the goods arranges for the financing prior to the actual delivery of the items, and the second where the documents of title to such property are already in his possession before he finds financial assistance necessary, it is now possible to analyze each in detail.

The first of these follows the general pattern developed at common law with the trustee ordering the goods from the seller and the entruster paying either the full purchase price or a portion thereof and acquiring a security interest in the items bought under the familiar tri-partite arrangement, but cumbersome and highly

<sup>73</sup> *In re Otto-Johnson Mercantile Co.*, 52 F. (2d) 678 (1928); *Armstrong v. Greenwich Motor Corporation*, 116 Conn. 487, 165 A. 598 (1933); *Ivy v. Commercial Credit Co.*, 173 Wash. 360, 23 P. (2d) 19 (1933).

<sup>74</sup> See comment in *Commissioners' Prefatory Note to the Uniform Act to be found in 9 Unif. Laws Anno. 665, § A, par. 3.*

artificial requirements such as that the bill of lading under which the goods are shipped must be made out to the seller, endorsed in blank by him, and delivered to the entruster, or else be made out directly to the latter, have been eliminated. It is now possible for the entruster to acquire his security interest from either the seller or the trustee;<sup>75</sup> the property may be delivered to the trustee either by the entruster or a third person such as the seller; and the security interest can be acquired by the entruster either at the time the goods or documents are delivered to the trustee or promptly thereafter.<sup>76</sup> In this fashion, the parties are no longer compelled to make certain that the security title vests in the entruster before the trustee acquires possession of the documents of title or the goods.

While these changes are highly desirable, they do raise some technical questions. It is possible, under the foregoing provisions, that the entruster might pay the purchase price directly to the seller and acquire possession of the goods, or at least of the documents of title, taking it upon himself to deliver the same to the trustee. Under these circumstances it could be argued that the entruster, having thereby bought the property, would then be engaged in reselling to the trustee and, as the security interest he retains may include title,<sup>77</sup> such a course of dealing would have all the attributes of a conditional sale. It must be remembered, however, that the entruster does not actually sell the property to the trustee; he merely finances the purchase. His purpose in dealing with the latter is wholly different from that of a seller for he is not interested in where the goods were bought nor in what items were purchased.

It might also be argued that by allowing the interest of the entruster to be acquired from the trustee after that individual has obtained actual possession, the Act violates the old theory that only new acquisitions of property may be financed by trust receipts. Where the entruster obtains his interest after delivery

<sup>75</sup> UTRA § 2-1; Ill. Rev. Stat. 1947, Ch. 121½, § 167(1).

<sup>76</sup> UTRA § 2-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(a).

<sup>77</sup> See definition of security interest in UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(12).

to the trustee, however, he must do so promptly,<sup>78</sup> by reason of which the possession and full title of the trustee is not present for a long enough period of time to be apt to mislead third persons. Again, it might be argued that this type of transaction would closely resemble that of a chattel mortgage, yet here two distinctions are to be noticed. First, as possession under a trust receipt can only be retained for some purpose enumerated by the Act, presupposing that there is to be some affirmative action on the part of the trustee with respect to the property, the arrangement differs from the ordinary chattel mortgage which does not limit the mortgagor's possession and is satisfied by a mere retention of the goods. Second, since the Act does not offer the same amount of protection against claims by third parties as does the law pertaining to chattel mortgages, it is unlikely that the ordinary mortgagee, should he be possessed of a valid chattel mortgage, would seek benefit under this statute.

It is conceivable that an individual purchasing goods might reach the point of obtaining the bill of lading or other document of title before he finds himself in need of financial assistance. He may have paid the full purchase price to the seller and now be in need of new value or, having purchased on a credit basis, is now unable to meet the obligation when it falls due. Some of the state statutes take this into consideration by providing that an entruster may give new value and obtain a security interest in documents actually shown to him or to his agent at the place of business of either, even though such documents be retained by the trustee.<sup>79</sup>

<sup>78</sup> UTRA § 2-1(a)(iii); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(a).

<sup>79</sup> It will be noted that in the text of the Uniform Act the term "instruments" and not the word "documents" appears in connection with the definition of this type of transaction: UTRA § 2-1(b). The Act, as it now reads, would only permit an entruster to obtain a security interest in instruments but not in documents already in the possession of the trustee. A reference to the Commissioner's note under this section, however, reveals that the term "documents" was accidentally omitted from the final draft, and it was recommended that legislatures should include it in their enactments: 9 Unif. Laws Anno. 677, foll. § 2. The recommendation was followed in California, Connecticut, Illinois, Indiana, Massachusetts, Montana, New Jersey, New York, Oregon, South Dakota, Utah and Washington. In the foregoing states the transaction described in the body of the article is clearly possible. The states of Idaho, Maryland, Minnesota, Nebraska, New Hampshire, North Dakota, Pennsylvania, Tennessee and Virginia did not change the text so their statutes follow the Uniform Act. Even so, it will be remembered that in that type of transaction where the property is delivered to the trustee, the Act does permit the entruster to obtain his security interest after the

This seeming violation of the principles underlying the common-law tri-partite arrangement would not be so serious if the term "documents" was limited to bills of lading for then the financial advance would be made on newly-acquired goods, goods which had but recently arrived and were now waiting to be claimed from the carrier. But the term "documents" includes any document of title, is comprehensive enough to embrace a warehouse receipt, and therefore permits the trustee to warehouse a portion of his old inventory and then use the warehouse receipt as the basis for obtaining advances upon his old stock. Such a result is inconsistent with the basic theory behind trust receipt financing, and it would have been desirable for the framers to have expressly limited the use of the trust receipt to transactions involving newly acquired property.

There is occasion to note, in that regard, that the Illinois statute makes it even easier to employ the trust receipt in financing old inventories for it does not confine trust receipt financing to instances where the items in the possession of the trustee at the outset are simply documents, but specifically permits such a transaction in reference to tangible goods already owned by and in the trustee's possession.<sup>80</sup> As there is no provision that the tangible goods must have been recently acquired, it would therefore permit an entruster to obtain a security interest by making advances on property which has been in the trustee's possession for a considerable period of time,<sup>81</sup> thus serving to break down still more the separation between the trust receipt and other financing devices.

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goods, documents, or instruments have been delivered, provided he does so promptly : UTRA § 2-1(a) (iii). It might be urged that this would allow a trustee to arrange for financing after the property is in his possession, and, therefore, the omission of the term "documents" would be of little consequence. Uncertainty may be engendered, however, by the provision that the security interest must be acquired "promptly."

<sup>80</sup> Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(c). Similar provisions may be found in Conn. Gen. Stats., 1939 Supp., Ch. 230a, § B-1(c), and Burns' Ind. Stat. Anno. 1933, § 51-602-(1)(c).

<sup>81</sup> Deering Cal. Civ. Code, 1941 Supp., § 3014.5, p. 96, makes this possible at least with regard to automobiles for an amendment to the general statute provides that an entruster may obtain a security interest in new or used cars in the possession of a dealer and specifically declares that it makes no difference whether or not the dealer had been owner before the trust receipt transaction. See also Ore. Laws 1947, Ch. 93, amending Ore. Comp. Laws. Anno., § 75-101 et seq., in this respect. But see the case of *In re Chappell*, 77 F. Supp. 573 (1948), to the effect that authority to subject automobiles already owned to a trust receipt will not extend to other types of property such as electrical household appliances.

## 2. *Trust Receipts and Pledged Property*

A prime disadvantage to the use of the pledge is that once property has been delivered to the pledgee, the pledgor loses an asset which, if properly utilized, might provide funds that could be applied on the very debt for which the article was pledged. Obviously, it would be advantageous to all parties concerned to permit the pledgor to retake possession of this property, at least for the limited purpose of disposing of it and applying the proceeds to the satisfaction of his obligation, but the difficulty encountered at common law lay in the fact that, by returning the pledged property, the pledgee forfeited his interest therein and had no claim to it as against the purchasers or creditors of the pledgor.<sup>82</sup> It is apparent, then, that a pledgee would be acting very unwisely to part with possession unless he could retain an interest in the property as against third parties. At this point, the present Act renders an excellent service by permitting the trust receipt device to be used in connection with the surrender of goods, documents, or instruments by one who already has an interest therein by way of pledge,<sup>83</sup> provided always that the arrangement conforms to the other requisites of a trust receipt transaction.

Delivery to the pledgor for one of the purposes prescribed by the Act, which includes the sale of pledged property, and thus makes possible an application of the proceeds on the secured debt,<sup>84</sup> obviates defects in the common-law pledge. But the purpose for which instruments may be made the basis of a trust receipt transaction is not limited to sale but may extend to other affirmative acts, so pledged paper could be released to the pledgor in order that it might be deposited, registered, presented for collection, or

<sup>82</sup> *Schumann v. Bank of Cal.*, National Ass'n, 114 Ore. 336, 233 P. 860 (1925); *Colby v. Cressy*, 5 N. H. 231 (1830).

<sup>83</sup> Goods, documents, or instruments may be delivered to a trustee where the entruster already has a security interest in them: UTRA § 2-1(a)(i), Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(a). By definition, a security interest includes the interest of a pledgee: UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(12). Thus, the conclusion is inescapable that one having a pledgee's interest in goods, documents, or instruments may deliver them to the pledgor under a trust receipt.

<sup>84</sup> UTRA § 2-3(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(a).

renewed.<sup>85</sup> A stockbroker, for example, might retake pledged securities, sell them during a favorable market, purchase other stock, and return the substitute collateral without jeopardizing the rights of the entruster.<sup>86</sup>

Another available type of transaction might well be discussed under this heading as it is, in effect, a simultaneous pledge and trust receipt transaction. Under this arrangement an individual can, by advancing new value, acquire a security interest in instruments which are shown to him or his agent at either's place of business but which instruments are to be retained by the owner.<sup>87</sup> Theoretically, the instruments are pledged for the new value advanced and then immediately withdrawn under a trust receipt delivered to the pledgee-entruster as evidence of the fact that he has acquired an interest therein. Here, again, the purposes for which possession is retained by the pledgor-trustee must correspond to those enumerated in the Act or the arrangement is not a trust receipt transaction, but the use of the trust receipt in this manner can prove invaluable where immediate possession of the collateral by the pledgor would be either necessary or convenient.

### *3. Execution of the Trust Receipt*

After due attention has been given to see to it that the transaction involves the right type of parties, covers only permitted purposes, is based upon a proper consideration and fits into one of the recognized classifications for its use, there is one further step necessary to the creation of a trust receipt relationship. The trustee should sign and deliver to the entruster a writing (1) stipulating that the latter holds a security interest in goods, documents, or instruments delivered to the former or retained by him, and (2) containing a description of those articles.<sup>88</sup> There is no indication as to how complete the description must be, but reason would dictate that it should be sufficiently detailed to designate

<sup>85</sup> UTRA § 2-3(c); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(c).

<sup>86</sup> UTRA § 2-3(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(3)(a).

<sup>87</sup> UTRA § 2-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(b).

<sup>88</sup> UTRA § 2-1(b)(1); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(c)(I).

the exact goods, documents or instruments involved. Except for the requirement that the trust receipt must be signed by the trustee, no other formality is necessary to its execution.<sup>89</sup>

This requirement for written evidence operates as a statute of frauds and inures to the benefit of purchasers and levying creditors by protecting them from collusion between an alleged trustee and a purported entruster where, actually, no trust receipt transaction ever existed. Failure to take a trust receipt at all renders the statute inapplicable and deprives the entruster of its limited protection.<sup>90</sup> In this connection, an important question presents itself, *i. e.* when should the writing be received? The answer seems to be that it depends entirely upon the nature of the transaction involved. If goods, documents, or instruments are delivered to the trustee, the trust receipt should be received simultaneously with such delivery, as it is from that time on that the entruster is concerned with preserving his security interest. On the other hand, if the property is already in the trustee's possession, the writing should be delivered at the time the entruster provides new value, since it is then that he acquires a security interest which requires protection.

There is one situation, however, where the giving of new value or delivery of goods, documents, or instruments need not be accompanied by the receiving of a trust receipt and that is where either are performed in pursuance of and in reliance upon a contract to execute a trust receipt.<sup>91</sup> Such a contract, if in writing and signed by the trustee, may be deemed the equivalent of a trust receipt,<sup>92</sup> and may be executed either prior to or concurrent with the delivery of the property or the giving of new value.<sup>93</sup> There is obvious advantage in such a contract at least in the first type of transaction for while, at the time preliminary arrangements are being made, the entruster and trustee may be in direct touch with

<sup>89</sup> UTRA § 2-2; Ill. Rev. Stat. 1947, Ch. 121½, § 167(2).

<sup>90</sup> *Associates Discount Corporation v. C. E. Fay Co.*, 307 Mass. 577, 30 N. E. (2d) 876 (1941).

<sup>91</sup> UTRA § 2-1(b) (ii); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1) (c) (II).

<sup>92</sup> UTRA § 4-1; Ill. Rev. Stat. 1947, Ch. 121½, § 169(1).

<sup>93</sup> UTRA § 2-1(b) (ii); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1) (c) (II).

each other, it is conceivable that when the new value is sent or credited to the trustee neither the entruster nor any of his agents may be present to demand and receive a trust receipt. In the case of delivery of goods, documents, or instruments, however, the contract would seem to serve little purpose for if the trustee is available to accept delivery he can just as readily sign and deliver the trust receipt.

A cursory examination of the section authorizing a contract to give a trust receipt<sup>94</sup> might lead to the belief that every such contract is equivalent to a trust receipt. A careful analysis will disclose, however, that this is not the case. The Uniform Act specifically states that such a contract is equivalent to a trust receipt where goods, documents, or instruments are *delivered to the trustee* in reliance thereon.<sup>95</sup> This would suggest that a contract to give a trust receipt would not be effective as a trust receipt if the transaction was one where the trustee already had possession of the property. There may be a logical reason for this distinction. Where an entruster attempts to obtain a security interest in instruments or documents which are in the possession of the trustee, the Act makes it necessary that such property be exhibited to him or his agent at either's place of business.<sup>96</sup> As this would necessitate that either the entruster or his agent be in personal touch with the trustee, a trust receipt could well be demanded at the time the new value was given and there would be no need for the protection afforded by a contract.<sup>97</sup> Conversely, a contract to give a trust receipt is effective as a trust receipt where, in pursuance thereof, goods, documents, or instruments are *delivered by the entruster*.<sup>98</sup> As the Act recognizes that the trustee may receive property either from the entruster or from a third person,<sup>99</sup> it would seem that if the latter made the delivery, even though

<sup>94</sup> UTRA § 4; Ill. Rev. Stat. 1947, Ch. 121½, § 169.

<sup>95</sup> UTRA § 4-1; Ill. Rev. Stat. 1947, Ch. 121½, § 169(1).

<sup>96</sup> UTRA § 2-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(b).

<sup>97</sup> Ill. Rev. Stat. 1947, Ch. 121½, § 169(1), makes no distinction, considering the contract to give a trust receipt as the equivalent of a trust receipt in either situation. See also Burns' Ind. Stat. Anno. 1944, § 51-604-1.

<sup>98</sup> UTRA § 4-1; Ill. Rev. Stat. 1947, Ch. 121½, § 169(1).

<sup>99</sup> UTRA § 2-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(a).



pursuant to a written contract, that contract would not be equivalent to a trust receipt. It is submitted that none of the distinctions mentioned have any real basis for their existence so, for the sake of clarity and understanding, the section should be rewritten with an eye to making all contracts to give trust receipts equivalent thereto.<sup>1</sup>

Assuming that a valid trust receipt has been brought into existence pursuant to the foregoing requirements, it is now possible to examine into its operation and effect both as it concerns the immediate parties and as it may serve to bind third persons.

#### B. RIGHTS BETWEEN IMMEDIATE PARTIES

The rights and duties of the entruster and trustee arising from a trust receipt transaction must, of necessity, be segregated into two classes: (1) those created by the fact that the trustee is indebted to the entruster, and (2) those created by the fact that the security for that obligation is in the possession of the trustee. The first represents nothing more than a debtor-creditor relationship, and the terms of the obligation, such as the maturity date, the amount owed, and the rate of interest, are the items which determine their rights and duties with respect to the indebtedness. Obviously, there is nothing in this which is peculiar to trust receipt law and, therefore, it is understandable why the Act does not purport to govern the parties with reference to the debt. All that need be remembered in regard to the obligation itself is that it remains due and owing no matter what happens to the security,<sup>2</sup> unless it is in some manner cancelled by the creditor.

As the primary interest in any discussion of trust receipts revolves around the rights of the parties with reference to the trust receipt property, it is essential to determine the origin of these rights. The trust receipt itself has always been one source.

<sup>1</sup> While UTRA § 4-2, Ill. Rev. Stat. 1947, Ch. 121½, § 169(2), directs that the contract to give a trust receipt, if in writing, may be specifically enforced in equity, the wise entruster will obviate unnecessary litigation by insisting upon a formal written and signed trust receipt in every instance. Is there not occasion, however, to provide statutory basis for specific performance of an *oral* contract to give a trust receipt provided the oral contract has been performed sufficiently to take the case out of a typical statute of frauds?

<sup>2</sup> C. I. T. Corporation v. Hawley, 34 Cal. App. (2d) 66, 93 P. (2d) 216 (1939).

The Act, recognizing this fact, provides that “. . . the terms of the trust receipt shall, save as otherwise provided by this Act, be valid and enforceable.”<sup>3</sup> Since there are provisions governing the right of the parties with regard to (1) repossession of the trust receipt property, and (2) default, the statute functions as a second source, supplanting the terms of the trust receipt in these two instances.

### *1. Terms of the Trust Receipt*

Many of the forms utilized by various entrusters provide that the trustee is to hold the property at his own risk;<sup>4</sup> in other words, if it is lost through damage or depreciation, the trustee and not the entruster will bear the loss. Accordingly, whatever befalls the property, the debt is still due and owing.<sup>5</sup> This would seem to be an inherent feature of the trust receipt device and would probably be present even though no provisions concerning risk were embodied in the agreement. Of course, if the property is actually destroyed, the entruster also stands to suffer a loss. He not only loses his security but as, in most cases, the trustee is counting on the proceeds from the sale thereof to retire the indebtedness, the entruster may also lose the source of payment. In order to protect himself against such eventuality, it has been the practice to stipulate that the trustee is to insure the goods, making the policy payable to the financier,<sup>6</sup> thereby providing a secondary fund out of which the debt may be satisfied. In rare instances, the entruster has been known to agree to insure the property himself.<sup>7</sup>

Along with the above, the entruster will often provide that all expenses which accrue against the trust receipt property such as taxes, storage charges, and the like, must be paid by the trustee.<sup>8</sup>

<sup>3</sup> UTRA § 5; Ill. Rev. Stat. 1947, Ch. 121½, § 170.

<sup>4</sup> See trust receipt used in *General Motors Acceptance Corporation v. Mayberry*, 195 N. C. 508, 142 S. E. 767 (1928).

<sup>5</sup> See case cited in note 2, ante.

<sup>6</sup> See trust receipt in *Century Throwing Co. v. Muller*, 197 F. 252 (1912).

<sup>7</sup> Note provision in receipt in *Armstrong v. Greenwich Motor Corporation*, 116 Conn. 487, 165 A. 598 (1933).

<sup>8</sup> See forms used in *C. I. T. Corporation v. Seaney*, 53 Ariz. 72, 85 P. (2d) 713 (1938); *Associate Discount Corporation v. C. E. Fay Co.*, 307 Mass. 577, 30 N. E. (2d) 876 (1941); *B. C. S. Corporation v. Colonial Discount Co.*, 169 Misc. 711. 8 N. Y. S. (2d) 65 (1938).

Even if these provisions were not inserted, it would appear that, since the entruster is merely financing the purchases, there would be no question as between the parties but what the trustee should be liable for such charges for the entruster's interest is essentially only one for security purposes and charges of that character typically fall on the real owner.

The entruster will also attempt to forestall any third person such as a mortgagee or pledgee from being able to claim rights in the trust receipt property. It will be recalled that these individuals were usually given preference over the entruster at common law and, as will be seen later, this is still true to a limited extent even under the Act. It therefore behooves the entruster to attempt to bring to the actual notice of third parties the fact that the property, although in the possession of the entruster, is trust receipt property. To that end, he may require the trustee to place and maintain tags upon the property identifying it as that of the entruster<sup>9</sup> and, if the property is to be manufactured or processed, may provide that it should be kept identifiable after such operation as well as while in the raw state.<sup>10</sup>

Where the trustee is given the liberty of sale his authority is often limited by the agreement. For instance, the entruster may provide that the trustee is only to sell on written consent,<sup>11</sup> or only for cash,<sup>12</sup> or for a specified sum.<sup>13</sup> In some cases it may be provided that the trustee is not to sell until the full debt is paid.<sup>14</sup> It must be remembered, however, that while these provisions are binding upon the trustee, they have no effect upon third parties such as purchasers unless actually brought to their

<sup>9</sup> Consider form found in *C. I. T. Corp. v. American Nat. Bank*, 256 Ill. App. 38 (1930).

<sup>10</sup> *Brown v. Green & Hickey Leather Co.*, 224 Mass. 168, 138 N. E. 714 (1923); *Peoples Nat. Bank v. Mulholland*, 228 Mass. 152, 117 N. E. 46 (1917).

<sup>11</sup> Note provision in trust receipt used in *C. I. T. Corporation v. Seaney*, 53 Ariz. 72, 85 P. (2d) 713 (1938).

<sup>12</sup> See trust receipts used in *Century Throwing Co. v. Muller*, 197 F. 252 (1912), and in *Armstrong v. Greenwich Motor Corporation*, 116 Conn. 487, 165 A. 598 (1933).

<sup>13</sup> See forms utilized in *Associate Discount Corporation v. C. E. Fay Co.*, 307 Mass. 577, 30 N. E. (2d) 876 (1941), and in *Chichester v. Commercial Credit Co.*, 37 Cal. App. (2d) 439, 99 P. (2d) 1083 (1940).

<sup>14</sup> *General Motors Corporation v. Kline*, 78 F. (2d) 618 (1935).

attention.<sup>15</sup> When a sale does occur, the entruster is naturally interested in the proceeds as they provide a means of liquidating the obligation owed him. It is, therefore, more than likely that he will stipulate in the trust receipt that the proceeds are to be turned over to him.<sup>16</sup> At common law, if after the trustee acquired the proceeds he became bankrupt, the entruster could not claim them unless he could identify the very proceeds arising from the sale.<sup>17</sup> The Act, as will be seen later, has modified this rule somewhat, but it is still customary to insert a provision requiring the trustee to keep the proceeds of any such sale separate and identifiable and forbidding him from intermingling them with his own property.<sup>18</sup>

There is one peculiarity in all trust receipt agreements: they never expressly indicate that the security title of the entruster is to be defeated by full payment of the debt as is customary in real-estate mortgages. However, most courts would recognize that this is an implied term of the contract since all that the entruster has is an interest to secure the performance of an obligation and should have no further rights after performance has been had.<sup>19</sup> Absence of express language on the point, in the trust receipt or in the statute, may well be excused.

## 2. *Repossession and Rights Upon Default*

As previously mentioned, the conditions of repossession and default are not governed by the terms of the trust receipt, but by the Act itself. At common law, after default upon the obligation, the entruster could simply seize the trust receipt property without the necessity of conforming to any formalities, sell it, and apply the proceeds upon the debt. This was accomplished by embodying

<sup>15</sup> UTRA § 9-2(a) (ii); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2) (a) (II).

<sup>16</sup> See form in *Armstrong v. Greenwich Motor Corporation*, 116 Conn. 487, 165 A. 598 (1933).

<sup>17</sup> *In re Mulligan*, 116 F. 715 (1902); *Vaughan v. Massachusetts Hide Corporation*, 209 F. 667 (1913).

<sup>18</sup> *C. I. T. Corp. v. American Nat. Bank*, 256 Ill. App. 38 (1930).

<sup>19</sup> There are no cases directly in point, but see opinions in *Vaughan v. Massachusetts Hide Corporation*, 209 F. 667 (1913); *Smith v. Commercial Credit Corporation*, 113 N. J. Eq. 12, 165 A. 637 (1933); *Mershon v. Wheeler*, 76 Wis. 502, 45 N. W. 95 (1890).

a provision in the agreement permitting the taking of the property at any time, a right recognized by the courts upon the theory of title in the entruster.<sup>20</sup> In most cases today, however, the entruster does not advance up to the full value of the property and the trustee has a financial investment therein which should be protected by regulating the former's right to dispose of the property on default. The framers of the present Act, realizing this, have made it mandatory for the entruster to abide by certain formalities before he can realize upon his security.

As between the trustee and entruster, the latter is given the right to possession upon default.<sup>21</sup> The term "default" raises the problem of whether it simply denotes nonpayment of the debt at maturity or includes any breach of the various terms of the trust receipt, but as the Act also permits the entruster to take possession according to the tenor of the agreement,<sup>22</sup> and since the writing usually provides for repossession "at any time,"<sup>23</sup> "whenever the entruster feels insecure,"<sup>24</sup> or "upon demand,"<sup>25</sup> it is obvious that the right of possession need not depend upon the existence of a default as that term is customarily used. Merely by embodying one of the aforementioned provisions in the trust receipt and exercising the option, the entruster can acquire an absolute right to possession. One might be led to the conclusion that this absolute right is far too arbitrary but it must be mentioned that the entruster is not completely protected for the Act merely offers a limited safeguard against the rights of third persons. Considerable faith must be placed in the honesty and integrity of the trustee, and if this reliance should prove unfounded, the existence and exercise of an absolute and immediate

<sup>20</sup> *General Motors Acceptance Corp. v. Dunn Motors*, 172 Ga. 400, 157 S. E. 627 (1931); *Scott v. Industrial Finance Corporation*, 265 S. W. 181 (Tex. Civ. App., 1924). See also *Industrial Finance Corporation v. Turner*, 215 Ala. 460, 110 S. 904 (1927).

<sup>21</sup> UTRA § 6-1; Ill. Rev. Stat. 1947, Ch. 121½, § 171(1).

<sup>22</sup> *Ibid.*

<sup>23</sup> *B. C. S. Corporation v. Colonial Discount Co.*, 169 Misc. 711, 8 N. Y. S. (2d) 65 (1938).

<sup>24</sup> *Associates Discount Corporation v. C. E. Fay Co.*, 307 Mass. 577, 30 N. E. (2d) 876 (1941).

<sup>25</sup> *Scott v. Industrial Finance Corporation*, 265 S. W. 181 (Tex. Civ. App. 1924).

right to regain possession might be the only way to prevent serious loss.

In opposition, it is unlikely that options of this character would be exercised capriciously for, by indulging in such practices, the entruster would not only jeopardize his reputation, risk the loss of further financing opportunities, but would gain no appreciable advantage. The Act does not permit the entruster to sell the property until there has been a default,<sup>26</sup> so any trustee who had been imposed upon could, by meeting his obligations promptly, prevent a sale of his property and, upon payment of the entire debt, demand its return.<sup>27</sup> It is probable, of course, that the trustee may have been relying upon the proceeds from the sale of the very goods held under the trust receipt to liquidate the debt so that, by being deprived of the property, he will be forced to default. If he could not obtain refinancing, the entruster would eventually be permitted to sell the property but even so any surplus arising from such sale must be returned to the trustee,<sup>28</sup> hence there is little opportunity for financial gain to the entruster or loss to the trustee, except as property sold under distress circumstances may fail to produce its true worth.

Having determined that the entruster has an absolute right to possession which he can ordinarily exercise at any time he desires, the next question is: by what methods can he retake the property? It is possible that the trustee will return it upon a simple demand, particularly if he intends to utilize this financing device in the future, for any difficulty encountered by one entruster would adversely affect the trustee's credit standing with others in the business. If not, the Act makes it possible for the entruster to seize the property without legal process if this can be accom-

<sup>26</sup> UTRA § 6-3(b); Ill. Rev. Stat. 1947, Ch. 121½, § 171(3)(b).

<sup>27</sup> When the entruster takes possession of the property, he holds it as a pledgee: UTRA § 6-3(a), Ill. Rev. Stat. 1947, Ch. 121½, § 171(3)(a). One of the duties of a pledgee is to return the property as soon as the debt is paid, and a refusal to do so upon demand would constitute a conversion: Brown, *A Treatise on the Law of Personal Property* (Callaghan & Co., Chicago, 1936), § 103.

<sup>28</sup> UTRA § 6-3(b); Ill. Rev. Stat. 1947, Ch. 121½, § 171(3)(b).

plished without a breach of the peace.<sup>29</sup> The problem as to what constitutes a breach of the peace depends entirely upon the facts in a given situation and, therefore, will not be discussed.<sup>30</sup> A far more important item is whether the seizure must be preceded by a demand. A retaking by the vendor under a conditional sales contract would seem to present an analogous situation, and in this respect the courts have held that if the agreement embodies a provision for demand, it is necessary.<sup>31</sup> If it specifically states that no demand is essential, then none is required.<sup>32</sup> If no reference is made either way, courts have decided that a demand is not a requisite.<sup>33</sup> An entruster who cannot acquire possession of the property without legal process will have to avail himself of one of the various forms of action provided by law. Since he has both a right to immediate possession and some type of interest in the property, it is apparent that replevin would be an appropriate remedy,<sup>34</sup> or in some states statutory detinue.<sup>35</sup>

Once the entruster acquires possession, he holds the property as a pledgee, but with the additional right to sell in the manner prescribed by the Act and also to exercise a forfeiture of the trustee's interest under certain circumstances.<sup>36</sup> It is only logical that the entruster should be treated as a pledgee for, at this point, the relationship between the parties closely resembles that of pledgor-pledgee; the entruster having possession of property as security for a debt or obligation owed to him while the rights of the trustee have not yet been entirely extinguished. The rights and

<sup>29</sup> UTRA § 6-2; Ill. Rev. Stat. 1947, Ch. 121½, § 171(2). In North Dakota, under Laws 1945, Ch. 320, § 6-2, there has been substituted a provision that possession may be obtained "... in any manner permitted by law for taking possession of personal property subject to lien."

<sup>30</sup> As to what is considered peaceful taking in the case of repossession of property by a mortgagee or a conditional vendor, see Jones, *The Law of Chattel Mortgages and Conditional Sales* (The Bobbs-Merrill Co., Indianapolis, 1933), 6th Ed., §§ 705, 1339 and 1340.

<sup>31</sup> *Young v. Corbitt Motor Truck Co.*, 148 S. C. 511, 146 S. E. 534 (1929).

<sup>32</sup> *Vorenberg v. American House Hotel Co.*, 246 Mass. 108, 140 N. E. 297 (1923).

<sup>33</sup> *Wooley v. Williams*, 105 Conn. 671, 136 A. 583 (1927); *Proctor v. Tilton*, 65 N. H. 3, 17 A. 638 (1889).

<sup>34</sup> These are the requisites for the maintenance of such an action in Illinois: *Gazelle v. Doty*, 73 Ill. App. (1898); *Persels v. McConnell*, 16 Ill. App. 526 (1885).

<sup>35</sup> This type of action was held appropriate in *Industrial Finance Corporation v. Turner*, 215 Ala. 460, 110 S. 904 (1927).

<sup>36</sup> UTRA § 6-3(a); Ill. Rev. Stat. 1947, Ch. 121½, § 171(3)(a).

duties of a pledgee under such circumstances, not being peculiar to trust receipt transactions, are amply treated elsewhere and do not warrant repetition.<sup>37</sup>

One point does become significant, however, for the entruster's right to sell the trust receipt property is limited to a "default,"<sup>38</sup> a term which requires some discussion for upon it hinges the entruster's privilege of sale. Does it simply mean nonpayment of the obligation, or does it have reference to any breach of the many provisions which may be embodied in a trust receipt? That term has been defined, in standard dictionaries, as the "omission or failure to fulfill a duty, observe a promise, discharge an obligation, or perform an agreement." Using this broad definition, reason would dictate that the entruster could exercise his privilege of sale upon the breach of any provision of the trust receipt, and not solely because of nonpayment of a debt due and owing. The advisability of utilizing this broad definition can be argued either way. Observing the situation from the entruster's point of view, each of the provisions embodied in the trust receipt were written in for his protection and, if they are not complied with, he is not receiving the safeguards contracted for. Under those conditions he should be able to withdraw from the arrangement and, if the debt due him cannot be satisfied by any other method, he should have the privilege of selling the security. On the other hand, it might be urged that since the main purpose for allowing a sale is to permit the entruster to realize upon the security only when he is unable to do so on the obligation, sale should be confined to those circumstances. The mere fact that one of the minor provisions of the trust receipt might have been breached does not necessarily mean that the debt will not be paid. It can only be noted, however, that this remains one of the unsettled points on the subject but doubt might be removed if the obligation contained a clause permitting acceleration in case of breach of any of the conditions of the trust receipt.

<sup>37</sup> Schouler, *A Treatise on the Law of Personal Property* (Matthew Bender & Co., Inc., New York, 1918), 5th Ed., § 401 et seq.

<sup>38</sup> UTRA § 6-3(b) ; Ill. Rev. Stat. 1947, Ch. 121½, § 171(3) (b).



Before any privilege of sale can be exercised, the entruster must notify the trustee in writing five days prior to the disposal of the goods,<sup>39</sup> which notification may be served personally or mailed to the last known business address of the trustee.<sup>40</sup> While the sale may be either a public or a private one, the entruster can only become a purchaser of the trust receipt property at the former,<sup>41</sup> hence the notice ought to be adequate for the purpose as well as specific with reference to the time and place. Since bidding at a public sale is apt to be more spirited and there is less likelihood that the entruster could, through collusion, purchase the property at a fraction of its actual value, the former method would seem more desirable from the standpoint of the trustee who, while entitled to any surplus, is also liable for any deficiency.

The funds realized from either type of sale are to be applied (1) to pay the expenses thereof; (2) to pay the cost of taking, keeping, and storing the property; and (3) to satisfy the indebtedness, priority being given in that order.<sup>42</sup> The first item is self-explanatory; the second allows the entruster to secure reimbursement for all expenses he has incurred with reference to the property up to the time of its sale, and would probably include all necessary attorney's fees and court costs;<sup>43</sup> the third, coupled with the next provision to the effect that the trustee is entitled to any surplus and liable for any deficiency, is merely a restatement of the common law.<sup>44</sup>

It is conceivable that an entruster might dispose of trust receipt property in the absence of a default or in a manner contrary to the requirements of the Act. His action would be in derogation of the trustee's rights and could well form the basis of a suit. However, the trustee's recourse is only against the

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.* The right to such notification belongs only to the trustee, so no one else can object if it is not properly given: *C. I. T. Corporation v. Commercial Bank of Patterson*, 64 Cal. App. (2d) 722, 149 P. (2d) 439 (1944).

<sup>41</sup> UTRA § 6-3(b); Ill. Rev. Stat. 1947, Ch. 121½, § 171(3)(b).

<sup>42</sup> *Ibid.*

<sup>43</sup> A provision calling for reasonable attorney's fees is often included in the trust receipt. See form used in *C. I. T. Corporation v. Seaney*, 53 Ariz. 72, 85 P. (2d) 713 (1938).

<sup>44</sup> *Charavay & Bodvin v. York Silk Mfg. Co.*, 170 F. 819 (1909).

entruster, the Act providing that a "purchaser in good faith and for value from an entruster in possession takes free of the Trustee's interest, even in a case in which the Entruster is liable to the Trustee for conversion."<sup>45</sup> As both "purchaser" and "value" are defined terms under the Act,<sup>46</sup> there can be no dispute as to the class of individuals protected by this provision.

Sale by the entruster is not the only method by which the trustee's interest in trust receipt property may be lost. The parties to the transaction may, after default, enter into an agreement whereby the trustee surrenders his interest in the property;<sup>47</sup> even a complete forfeiture is conceivable. As the Act specifically forbids the inclusion of a forfeiture clause in a trust receipt except as to certain items,<sup>48</sup> the operation of these two provisions would seem inconsistent except as a careful analysis of the trustee's position makes the distinction apparent. At the time he enters into the agreement, being a necessitous man, he would be prone to accept any conditions that the lender might impose and needs protection against ill-advised action. After default, no longer obliged to accept every proposal dictated by the entruster, he is in a position to judge for himself which course would benefit him most. Settlement at that time by agreement is reasonable as it facilitates the winding up of the transaction and makes unnecessary the foreclosure formalities set forth in the statute.

Since the entruster usually advances eighty to eighty-five per-cent. of the purchase price, the trustee will have an investment of only fifteen to twenty per-cent. in the property he holds under a trust receipt. Any substantial depreciation in its value will almost always wipe out his interest, leaving barely enough to

<sup>45</sup> UTRA § 6-3(c); Ill. Rev. Stat. 1947, Ch. 121½, § 171(3)(c).

<sup>46</sup> "Purchaser" means any person taking by purchase. A pledgee, mortgagee or other claimant of a security interest created by contract is, in so far as concerns his specific security, a purchaser and not a creditor." UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(11). "Value" means any consideration sufficient to support a simple contract. Any antecedent or pre-existing claim, whether for money or not, and whether against the transferor or against another person, constitutes value where goods, documents or instruments are taken either in satisfaction thereof or as security therefor." UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(15).

<sup>47</sup> UTRA § 6-4; Ill. Rev. Stat. 1947, Ch. 121½, § 171(4).

<sup>48</sup> UTRA § 5; Ill. Rev. Stat. 1947, Ch. 121½, § 170.

cover the indebtedness due the entruster. The Act takes this into consideration and provides that the parties may embody a clause in the trust receipt whereby the trustee, upon default, is to forfeit his entire interest in the property but then only if the property consists of goods "manufactured by style or model."<sup>49</sup> Merchandise of this character suffers a large depreciation in a relatively short period of time for new models or styles are placed on the market periodically, thereby rendering the old obsolescent if not obsolete. Where property of this type is involved, the trustee's interest has usually been wiped out by the time any default takes place so it is understandable why the Act should permit the trustee to agree to forfeit his interest on default and make foreclosure unnecessary. This privilege may be exercised at the election of the entruster, and its presence should have no effect upon his other remedies.<sup>50</sup> Where a forfeiture is claimed, the entruster must be willing to permit a cancellation of the indebtedness on a sliding scale. If the default occurs upon the maturity date of the original obligation, at least eighty per-cent. of the purchase price or of the indebtedness, whichever is larger, must be cancelled.<sup>51</sup> If it occurs on the maturity date of the first renewal, then the cancellation must be at least seventy per-cent. of the alternative figure mentioned. In the case of any further renewal, the figure is sixty percent.<sup>52</sup>

<sup>49</sup> UTRA § 6-5; Ill. Rev. Stat. 1947, Ch. 121½, § 171(5). For an example of this type of clause, see trust receipt used in *Commercial Discount Co. v. Los Angeles County*, 16 Cal. (2d) 158, 105 P. (2d) 115 (1940).

<sup>50</sup> The Illinois statute makes certain of this by providing that the right to exercise the forfeiture privilege is "... an alternative to the remedies hereinbefore provided. . . ." See Ill. Rev. Stat. 1947, Ch. 121½, § 171(5).

<sup>51</sup> UTRA § 6-5. Both the Illinois and Indiana statutes merely provide for the cancelling of 80% of the indebtedness and do not provide for the alternative of cancelling an amount equal to 80% of the purchase price, if that should be larger: Ill. Rev. Stat. 1947, Ch. 121½, § 171(5); Burns' Ind. Stat. Anno. 1933, § 51-606(5).

<sup>52</sup> There is ambiguity in the language of UTRA § 6(5) since it is not too clear whether the 80% factor relates to both purchase price and original indebtedness or simply to the former. If to both, a loan not exceeding 80% of the purchase price would seemingly be extinguished by forfeiture, but a loan for a larger amount would not be so extinguished and would still leave the trustee subject to a deficiency. The procedure is not entirely comparable to the strict foreclosure of a real estate mortgage.

## C. EFFECT ON THIRD PARTIES

The operation of a trust receipt transaction between the immediate parties having been considered, the next item of importance is to determine its effect, and the effect of the entruster's security interest in the property, upon third persons. In that respect many questions may arise but, as the present Act divides such third persons into two categories, to-wit: creditors and purchasers, these several problems can best be considered under those sub-headings. The first group includes not only individual creditors but also those represented by a trustee in bankruptcy, a receiver in insolvency, or an assignee for the benefit of creditors. The term "purchasers," on the other hand, takes in every type of individual who for value acquires a specific interest in the trust receipt property while it is in the possession of the trustee and includes purchasers, mortgagees, pledgees, subsequent entrusters and the like.

*1. Creditors of the Trustee*

The crux of the conflict in the earlier decisions concerning the validity of an unrecorded trust receipt as against the trustee's creditors represented merely a difference in the attitude of the various jurisdictions concerning the necessity of protecting creditors of the trustee against the secret lien of the entruster. Outside of this difference, the cases are in harmony for it was never contended that the primary parties were not bound by their agreement, and the conclusion to protect bonafide purchasers from this type of lien nowhere met with opposition. As to creditors, however, the situation was entirely different. Some courts were willing to sacrifice them to the needs of business while others declined so to do, believing that unless the trust receipt was recorded the creditors of the trustee should have the right to levy upon the property in order to satisfy their claims. The former group treated the trust receipt as a valid security device even though not recorded; the latter, seeking to protect creditors, drew various analogies between it and a mortgage or conditional sale agreement, leading to an insistence upon recordation. The task of reconciling

these two views, each of which has merit, was a problem faced by the framers of the present Act. Undisputably, business needs demanded a type of security device fashioned along the lines of the common law trust receipt; on the other hand, the needs of creditors could not be entirely disregarded. The problem was solved by first recognizing that all creditors did not stand in the same position; some were entitled to more consideration than others. For that reason, the Act draws a distinction between individual levying creditors or those represented by either a trustee in bankruptcy or a receiver in insolvency on the one hand, and those obtaining a specific lien against the property for work and services on the other. The former are given a limited amount of protection, while the latter are fully safeguarded.

#### *a. General Creditors*

As against the ordinary general creditors of the trustee, the security interest of the entruster is valid for thirty days after delivery of the goods, documents, or instruments, irrespective of whether such creditors have actual or constructive notice of its existence.<sup>53</sup> No creditor can satisfy his claim out of the trust receipt property during that period and, as a consequence, the Act creates an absolute and unconditional secret lien for a limited time. State legislatures enacting this provision must have felt that the advantage to be gained by doing away with the necessity for recording a security device so frequently utilized in connection with short-term loans would far outweigh the ill-regarded aspects of the secret lien. It is not for the courts to question their wisdom.<sup>54</sup>

The precise duration of that secret lien, however, is not easy to fix. The Act provides a method for its calculation, but to understand the operation of the statute one must recall that there are two kinds of transactions falling within its scope. The first occurs where goods, documents, or instruments are delivered to

<sup>53</sup> UTRA § 8-1; Ill. Rev. Stat. 1947, Ch. 121½, § 173(1). Idaho does not recognize the thirty-day period of validity without recordation: Ida. Laws 1945, Ch. 73, § 8-2.

<sup>54</sup> See comment in *In re Boswell*, 96 F. (2d) 239 (1938), affirming 20 F. Supp. 748 (1937).

the trustee; the second where the items are in the trustee's possession at the outset.<sup>55</sup> It is necessary that these be treated separately, as the Act draws a distinction between them in determining the commencement of the thirty-day period.

In the first type of transaction, the date the property is delivered to the trustee becomes the controlling date.<sup>56</sup> Where the trust receipt is used to finance a single purchase and the goods are all received by the trustee on the same date, there is no complication. If the items are purchased under a contract making provision for several shipments, however, a new thirty-day term would seemingly commence with each delivery, covering the property received in that particular delivery. It might be difficult to ascertain the precise article received on any given date, especially where the chattels are similar in style and model and have no other identifying features, and in the absence of separate trust receipts covering each separate delivery there could be no end to the confusion which might result.

The seemingly simple and understandable statutory language also leads to other problems. The first is whether, after the thirty-day period has elapsed, the entruster could repossess the items, redeliver them under another receipt, and thus obtain the benefit of another term. As the framers of the Act used the word "delivery" and not "redelivery," the choice in language may be adequate to take care of the situation particularly when coupled with the necessity for new value to support each trust receipt. Certainly, such practice, even if possible within the wording of the statute, would scarcely conform to its spirit for the practical effect thereof would be to permit a secret lien of unlimited duration. Another problem involves somewhat similar circumstances except that the original articles are not redelivered but substituted property is given over. It might be argued that as the second lot of goods are new articles the entruster should be given the benefit of another, or really a distinctly new, term. If the second lot is, in reality, merely

<sup>55</sup> UTRA §§ 2-1(a) and 2-1(b); Ill. Rev. Stat. 1947, Ch. 121½, §§ 167(1)(a)(b) and (c).

<sup>56</sup> UTRA § 8-1; Ill. Rev. Stat. 1947, Ch. 121½, § 173(1).

a substitute, however, the situation should not be treated any differently than if the original articles had been redelivered.

Still another variation might arise. Suppose an entruster delivers a bill of lading under trust receipt to the trustee in order that the latter may obtain possession of the goods from the carrier for storage or processing. The thirty-day secret lien, at least as to the bill of lading, would commence as soon as that document was delivered and received. The goods having been stored, or processed and stored, the warehouse receipt is then turned over to the entruster in lieu of the bill of lading. In order to sell the property, the ultimate aim in most trust receipt transactions, the trustee later acquires possession of the warehouse receipt under another trust receipt and, through it, the precise goods previously handled. The question is, does the release of the warehouse receipt initiate another thirty-day period, or is it part and parcel of the first delivery of the bill of lading? The documents are different, but the goods represented thereby are the same. The solution is difficult, and the answer cannot be obtained from a reading of the Act.

Complicating matters still further, it is readily conceivable that the trustee might retain the articles for less than the thirty-day period, turning them back or having them retaken by the entruster and the latter keeping them for some part of the remaining portion of that time. If the entruster should restore the goods to the trustee, it might be argued that the interval during which the entruster held possession should not be counted as the Act permits a secret lien for a thirty-day period and time should cease to run when the necessity for a secret lien is suspended and not commence again until the entruster returns the property. Such an argument would seem to be out of the realm of practicality as it would be difficult, if not impossible, to compute the thirty days on such a basis, but again the statute fails to supply a precise solution and obviously needs clarification.

A different method of computation is used where, at the outset, the property is already in the possession of the trustee. Under most statutes, such a trust receipt transaction is permitted only in reference to instruments and documents. There the period com-

mences from the time the papers are actually shown to the entruster, or he gives new value, whichever is prior.<sup>57</sup> The date at which new value is given is important because it is then that the entruster acquires an interest and needs the protection afforded by the Act. It is difficult, however, to comprehend the reason for beginning such protection from the moment of exhibiting the instruments or documents, if that date was prior to the giving of new value, unless the framers were attempting to protect the entruster from the time he contemplated acquiring a security interest. From a business standpoint this is convenient, and perhaps necessary, for an individual might not be in position to transfer new value at the instant when the documents or instruments are exhibited to him but could well do so on a later occasion. During the interval between viewing the papers and the ultimate delivery of the consideration, creditors might have attached or made a levy upon the property. The entruster, but for this provision, would be required to ascertain whether anything of this nature had taken place, and such investigation would slow down business procedure, particularly where parties are separated by distance.

But again, peculiarities are introduced at least in those states which do not confine this type of transaction to documents and instruments but also apply it to goods.<sup>58</sup> In two such states, a distinction is made as to the time at which the thirty-day period starts. In the case of goods and documents, the time is figured from the date at which new value is given, but if instruments form the basis, the transaction is treated in the same manner as in the Uniform Act, *i.e.* the period is calculated from the time of exhibiting them or the giving of new value, whichever is prior.<sup>59</sup> There is no legitimate foundation for the drawing of a distinction between documents and goods on the one hand and instruments on the other in fixing the computation of the thirty-day period, and such artificial distinctions ought to be abolished.

<sup>57</sup> UTRA § 8-1; Ill. Rev. Stat. 1947, Ch. 121½, § 173(1).

<sup>58</sup> Conn. Gen. Stats., 1939 Supp., Ch. 230a, § B1(c); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(c); Burns' Ind. Stat. Anno. 1933, § 51-602-(1)(c).

<sup>59</sup> Ill. Rev. Stat. 1947, Ch. 121½, § 173(1); Burns' Ind. Stat. Anno. 1933, § 51-608(1).



Still another peculiar situation exists in Illinois where the term "new value" is defined to include the renewal or extension of advances or loans,<sup>60</sup> whereas these are expressly excluded under the Uniform Act.<sup>61</sup> As the giving of new value determines the commencement of the thirty days in most instances, it would be possible in Illinois, by making the original obligation run for less than thirty days and then by granting a renewal at maturity to prolong the transaction into an unlimited secret lien.

In many instances, a period of thirty days will be ample time in which to accomplish the purposes for which the trust receipt transaction was entered into and a secret lien for a longer period is neither necessary nor desirable. This would be true more often than not in cases involving instruments as the purpose for which possession thereof is given usually contemplates delivery, collection, or some other activity which can be consummated rapidly. Such is not always true in situations concerning goods or documents. As a result, the entruster will need to consider the measures to be taken to preserve his security interest against creditors after the initial thirty days have elapsed. The Act furnishes two alternatives. He can, of course, re-acquire possession of the trust receipt property promptly and, so long as he retains that possession, his interest is safeguarded.<sup>62</sup> This method will not be satisfactory in the majority of cases, as the very reason for the trust receipt is to allow the trustee to have possession. The other alternative, then, is for the entruster to give notice of his interest by utilizing the procedure established by the Act.<sup>63</sup>

An entruster who has complied with the recording provisions

<sup>60</sup> Ill. Rev. Stat. 1947, Ch. 121½, § 166(7).

<sup>61</sup> UTRA § 1.

<sup>62</sup> UTRA § 7-2; Ill. Rev. Stat. 1947, Ch. 121½, § 172(2). Section 1 of the Uniform Act, Ill. Rev. Stat. 1947, Ch. 121½, § 166(9), declares: "'Possession' as used in this act with reference to possession taken or retained by the Entruster, means actual possession of goods, documents, or instruments, or, in the case of goods, such constructive possession as, by means of tags or signs or other outward marks placed and remaining in conspicuous places, may reasonably be expected in fact to indicate to the third party in question that the entruster has control over or interest in the goods."

<sup>63</sup> UTRA § 13; Ill. Rev. Stat. 1947, Ch. 121½, § 178. The statute merely provides for filing where goods or documents are in the possession of the trustee under a trust receipt; no provision is made for filing where instruments form the basis of the transaction.

within the thirty-day period is protected against acts by any of the trustee's creditors after that period has lapsed.<sup>64</sup> If filing does not take place until after the term, the recording provides valid prospective notice but does not relate back.<sup>65</sup> As a consequence, during this intervening period, the entruster's interest lies unprotected, and a lien creditor who becomes such during that time without notice of the entruster's rights may attach or levy for the entruster's interest is void as to him.<sup>66</sup>

The term "lien creditor" is defined as one acquiring a specific lien by attachment, levy, or other similar judicial process, including a distraining landlord.<sup>67</sup> He is, in other words, a general creditor who has attempted to satisfy his claim out of the property held, and believed to be owned, by the trustee. As his right to seek satisfaction out of the trust receipt property depends upon the acquisition of his lien during the unprotected period, it becomes important to determine the exact time he becomes a lien creditor. The Uniform Act provides that a creditor's lien attaches as of the date the process is issued, provided it results in a levy or attachment within a reasonable time thereafter.<sup>68</sup> The term "issuance," when used in conjunction with legal processes or writs, is usually understood as referring to the time of the delivery thereof to the requisite executing officer<sup>69</sup> and the Massachusetts statute specifically recognizes this definition.<sup>70</sup> Unfortunately, the Illinois statute possesses no such provision and reference must be made to the general laws of the state in determining the time at which a general creditor becomes a lien creditor. The answer depends entirely upon the type of proceeding. For instance, a judgment becomes effective as a lien upon personal property as soon as the execution

<sup>64</sup> UTRA § 7-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 172(1)(a).

<sup>65</sup> UTRA § 7-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 172(1)(b).

<sup>66</sup> UTRA § 8-2; Ill. Rev. Stat. 1947, Ch. 121½, § 173(2).

<sup>67</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(6).

<sup>68</sup> UTRA § 8-3(a). The provision was omitted in the Illinois statute.

<sup>69</sup> *Oskaloosa Cigar Co. v. Iowa Cent. Ry. Co.*, 89 N. W. 1065 (Iowa, 1902); *Mills v. Corbett*, 8 How. Prac. (N. Y.) 500 (1853).

<sup>70</sup> Mass. Anno. Laws, Ch. 255A, § 8, provides: "For the purpose of this paragraph the date of the issuance of an original writ in an action at law shall be the date when it was placed in the hands of an officer for the purpose of making an attachment of the goods."

process is handed to the executing officer.<sup>71</sup> In attachment proceedings, the lien acquired by the judgment relates back to the time when the property was first levied upon.<sup>72</sup> In the case of a distress proceeding by a landlord, the lien attaches only when there is an actual seizure under the distress warrant.<sup>73</sup>

Notice of the entruster's security interest will always defeat the rights of levying creditors, in spite of the fact that no filing has taken place after the expiration of the thirty-day period,<sup>74</sup> but the term "notice" is not defined and a problem arises as to what kind of notice will suffice. Must the creditor have actual knowledge that the property he is about to levy upon is held under a trust receipt, or is it sufficient for him to know that his debtor finances purchases in this manner so that he might well suspect that the articles are so held? Where the Act requires the presence of actual notice of the entruster's security interest, as in the case of purchasers in the ordinary course of trade,<sup>75</sup> it uses that specific term. There may be indication from this fact that any type of notice should serve to defeat the rights of a levying creditor, but uncertainty on the point is not desirable.

The failure of the entruster to file or take possession of the property after the thirty-day period has elapsed also voids his security interest as against all ordinary creditors represented by either an assignee for their benefit, a receiver in equity, or a trustee in bankruptcy,<sup>76</sup> provided the representative attains his position at a time subsequent to the expiration of the thirty-day period and prior to any filing. Acquisition of status is determined in the

<sup>71</sup> Ill. Rev. Stat. 1947, Ch. 77, § 9. See also *Grimes v. Rodgers*, 263 Ill. App. 429 (1931).

<sup>72</sup> *Juillard v. May*, 130 Ill. 87, 22 N. E. 477 (1889); *Smith v. Clinton Bridge Co.*, 13 Ill. App. 572 (1883).

<sup>73</sup> *Powell v. Daily*, 163 Ill. 646, 45 N. E. 414 (1896); *National Cash Register Co. v. Wait*, 158 Ill. App. 168 (1910).

<sup>74</sup> UTRA § 8-2; Ill. Rev. Stat. 1947, Ch. 121½, § 173(2).

<sup>75</sup> UTRA § 9-2(a)(ii); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(a)(II).

<sup>76</sup> UTRA § 8-3(b); Ill. Rev. Stat. 1947, Ch. 121½, § 173(3). In accordance with this provision, the court in *In re McManus Motors*, 27 F. Supp. 113 (1939), held that trust receipts more than thirty days old were void as against a receiver where no statement had been filed. On the other hand, where in accordance with the Act a statement had been filed, the trustee in bankruptcy had no claim to the trust receipt property. See also *Chichester v. Commercial Credit Co.*, 37 Cal. App. (2d) 439, 99 P. (2d) 1083 (1940).

case of an assignee for the benefit of creditors as of the time of the assignment; in the case of a receiver, from the time of his appointment; and if he is a trustee in bankruptcy, from the time the petition was filed either by or against the insolvent trustee.<sup>77</sup> Personal knowledge on the part of the representative of the entruster's security interest, either prior to or at the time of his appointment, does not defeat the rights of the creditors represented. Only if, and when, all of the creditors have notice can it be said that their right to claim the benefit of the trust receipt property would be in jeopardy,<sup>78</sup> so the practical effect of this provision is to make a trust receipt transaction void as to the three types of representatives if the entruster fails to file after the lapse of the permissive secret lien. It might be noted that the same doubt exists here as to just what will constitute "notice" as was pointed out above.

#### *b. Creditors Claiming Artisan's Liens*

The rights of the ordinary general creditors of the trustee having been considered, it is now important to give thought to the second type of creditor whose position with respect to the entruster's security interest is regulated by the Act. He is the individual who obtains a lien against the trust receipt property in the ordinary course of business for work done or services expended thereon.<sup>79</sup> The case of *T. D. Downing Company v. Shawmut Corporation*<sup>80</sup> was probably the inspiration for the separate section of the Act dealing with this type of creditor. The defendant there concerned financed the importation of goods for an importer under a typical trust receipt arrangement. Upon arrival, the goods were placed in a bonded warehouse where they had to remain until the requisite customs duties were paid. The importer was not in financial position to meet these duties and could not obtain possession of the property. The plaintiff, a customs broker, made it a

<sup>77</sup> UTRA § 8-3(b) (i), (ii) and (iii); Ill. Rev. Stat. 1947, Ch. 121½, § 173(3) (I), (II) and (III).

<sup>78</sup> UTRA § 8-3(b); Ill. Rev. Stat. 1947, Ch. 121½, § 173(3).

<sup>79</sup> UTRA § 11; Ill. Rev. Stat. 1947, Ch. 121½, § 176.

<sup>80</sup> 245 Mass. 106, 139 N. E. 525 (1923).

practice to furnish funds for the payment of duties so that imports could be removed from the warehouse, advances being made only so long as the value of the merchandise still in bond was sufficient to cover the credit extended. Several advances were made to the importer for customs charges before that party defaulted upon his trust receipt obligation. The defendant-entruster, apparently having paid the customs duties on the property which still remained in the bonded warehouse, demanded delivery of the balance of the goods and the plaintiff allowed him to take possession. Thereafter, a suit was instituted against the defendant to recover the customs duties paid by the plaintiff on behalf of the importer. The court held that there could be no recovery against the defendant as he had only financed the purchase and no principal-agent relationship existed between him and the importer. The court went on to state that it was unnecessary to determine the extent of the plaintiff's lien upon the property, for he had lost it when he allowed the merchandise to be removed and surrendered to the defendant. The refusal to pass upon the question, however, left the impression that a lien might have been upheld had possession been retained.

Situations of this character are not uncommon, for much of the property received under a trust receipt is either to be stored, shipped, processed, or manufactured in preparation for sale. These operations will, in all probability, be carried out by persons other than the trustee, and the question is whether or not they can exert a lien against the property for their charges. Section 11 of the Uniform Act provides that an individual may acquire a specific lien against trust receipt property for services of this character, regardless of whether the entruster has or has not filed in accordance with the statute. The entruster, however, does not become personally liable for the debt. It is understandable why this type of creditor should receive more consideration for he either enhances or at least preserves the value of the merchandise through his labor and services, but the type of lien that he can assert is limited in two respects. It must be a specific lien for work and services rendered upon the very goods he is now holding, and the work done on the chattels must have been "in the usual course of the Trus-

tee's business preparatory to their sale.'<sup>81</sup> The second limitation does not restrict the lien appreciably for almost every operation could be construed as being one preparatory for the eventual disposition of the goods, but it might possibly be argued that the entruster would not be forced to respect the lien if any of the services or work were of an extraordinary or unusual nature, not rendered "in the usual course" of the trustee's business operations.

Although the entruster is not personally liable on the obligation for which a lien might be asserted, in actual practice it might be well for the entruster to consider paying the charges and taking possession of the trust receipt property to prevent greater loss through foreclosure of the lien of the artisan. Against that eventuality, the trust receipt should be so drafted as to provide not only that the trustee should pay such charges but that, if he does not, the entruster might have an election to pay the same and add the amount thereof to the secured indebtedness.

## *2. Purchasers from the Trustee*

While, generally speaking, the entruster's security interest is effective against all individuals for thirty days and, if the filing requirements are complied with, for a year thereafter,<sup>82</sup> there are some limitations to this rule as it applies to persons who acquire some type of interest in the trust property by giving value to the trustee. In this category fall all purchasers, mortgagees, pledgees, lessees, and subsequent entrusters for the Act makes it possible for them to acquire the property free from the entruster's interest under certain circumstances. These individuals are not treated alike, however, as the Act, while generically designating them as "purchasers," divides them into three categories, to-wit: (1) those who acquire any type of interest in negotiable paper, (2) those who purchase in the ordinary course of business, and (3) those whose interest is acquired not in the ordinary course of business. A consideration of the rights of each requires separate treatment.

<sup>81</sup> The requirement in UTRA § 11, Ill. Rev. Stat. 1947, Ch. 121½, § 176, that the lien be a specific one eliminates the possibility of a claim for a general lien and explains why a landlord's lien is excluded from this category.

<sup>82</sup> UTRA § 7-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 172(1)(a).

*a. Purchasers of Negotiable Paper*

Due to commercial necessity, negotiable instruments and documents have long been set apart from ordinary types of property, the law doing its utmost to protect purchasers of such paper, even though they acquire the same from one without title. There is no logical reason why this approach should be abrogated where the negotiable instrument or document is purchased from one holding it under a trust receipt, so when the question arose at common law it was held that the negotiable aspect of the documents enabled the purchaser from a trustee to acquire a title free of any rights reserved by the entruster.<sup>83</sup> The Act, following this lead, also provides that purchasers of negotiable instruments who buy from the trustee, for value and in good faith, acquire their interest free from that of the entruster's without regard to whether or not there has been a filing.<sup>84</sup>

Determination of the exact type of instrument or document falling within the purview of this section is essential. It must be negotiable, but the Act recognizes two classes: (1) those which are technically and actually negotiable, and (2) those which by common business practice are traded in as if negotiable.<sup>85</sup> Instruments or documents falling into the first classification are easily catalogued. The term "instruments" includes any negotiable paper as defined by the Uniform Negotiable Instruments Act and also such items as stocks, bonds, and similar commercial paper,<sup>86</sup> any of which, if negotiable, would come within the scope of this section. The term "documents" is defined as any document of title to goods,<sup>87</sup> and would embrace warehouse receipts and bills of lading, both of which can be negotiable. Documents or instruments falling into the

<sup>83</sup> *Roland M. Baker Co. v. Brown*, 214 Mass. 196, 100 N. E. 1025 (1913).

<sup>84</sup> UTRA § 9-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 174(1)(a).

<sup>85</sup> *Ibid.*

<sup>86</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(5). In *General Motors Ac. Corp. v. Associates Disc. Corp.*, 38 N. Y. S. (2d) 972 (1942), reversed on other grounds in 267 App. Div. 1032, 48 N. Y. S. (2d) 242 (1944), it was held that a conditional sales contract was not a negotiable instrument within this section and, therefore, the transferee of such paper could not claim the protection of a purchaser of a negotiable instrument.

<sup>87</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(2).

second category cannot be readily enumerated but included therein would be all paper which, though lacking the technical attributes of negotiability, have been treated as negotiable by custom and business usage. Whether or not any particular non-negotiable instrument or document falls within this latter classification would involve a question of fact dependent upon the amount of traffic in that type of paper and on the ease of its transferability.

The individual acquiring an interest in any one of the above-mentioned instruments or documents must be a purchaser<sup>88</sup> and, from the definitions of "purchase" and "purchaser" contained within the Act, it is ascertainable that either (1) a party purchasing full title, (2) a pledgee under a legal or equitable pledge, and (3) any other individual claiming a security interest under a contract, would meet the requirement.<sup>89</sup> It would also appear that anyone taking an interest in documents or instruments by way of a subsequent trust receipt transaction would fall within this group for the term "purchaser" seems to be sufficiently broad as to include a subsequent entruster. The validity of this conclusion is borne out by a specific provision in the Act stating that where an entruster obtains a security interest in property which is already held under a trust receipt, priorities are to be determined on the basis of this very section dealing with purchasers.<sup>90</sup> There is only **one difficulty**. An entruster, in order to obtain a security interest in property already in the possession of the trustee, is obliged to give *new value*,<sup>91</sup> while all that is demanded of a person invoking this section is that he give *value*. Since the former, however, is a more valuable type of consideration than the latter, it is unlikely that the specifying of value would exclude the possibility of giving new value so it can reasonably be assumed that one acquiring a security

<sup>88</sup> UTRA § 9-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 174(1)(a). A purchaser is defined as anyone taking by purchase: UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(11). "Purchase" is also a defined term and includes an acquisition of an interest through a sale, lease, mortgage, or pledge, be it legal or equitable: UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(10).

<sup>89</sup> The term "purchaser" also includes a "claimant of a security interest created by contract," according to UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(11).

<sup>90</sup> UTRA § 2-1; Ill. Rev. Stat. 1947, Ch. 121½, § 167(1).

<sup>91</sup> UTRA § 2-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 167(1)(b) and (c).



interest in negotiable instruments or documents under a subsequent trust receipt transaction is a "purchaser" for this purpose.

Before any purchaser can come within the scope of this Act, thereby obtaining its protection, he must have (1) acted in good faith, and (2) given value for his interest. Good faith is not a defined term under the Act but needs little consideration, as it is well-known throughout the law.<sup>92</sup> "Value," on the other hand, is defined as any consideration sufficient to support a simple contract, including an antecedent claim against the trustee or third party where the interest in the trust receipt property is taken in satisfaction of that claim or as security for it.<sup>93</sup> No distinction seems to be made between cases where the transferor of the interest is bound to satisfy the claim against a third party or where he does so merely as an accommodation.

The discussion so far has concerned itself with those negotiable documents or instruments which were either delivered to the trustee by the entruster or were in the trustee's possession at the outset of the transaction. It may happen, as it did in one case,<sup>94</sup> that the trustee is given a bill of lading under a trust receipt and with it acquires possession of goods which he then stores, obtaining a negotiable warehouse receipt. If that paper is subsequently delivered to a purchaser in good faith and for value, should he be given the same protection he would have received if the original bill of lading had been transferred to him? Carrying it one step farther, suppose that under the above circumstances the bill of lading had been acquired by the trustee for the purpose of obtaining possession of the goods either to sell or have them processed, nothing being said about storage. A subsequent warehousing by the trustee would be in breach of the agreement, but what of the rights of a purchaser of the negotiable warehouse receipt? A trustee selling goods, documents, or instruments, which he has

<sup>92</sup> Black Dict., citing a number of cases where the term has been used under various circumstances, defines it in substance as an honest attempt not to take advantage of any one plus the absence of any information which would render the transaction unconscionable.

<sup>93</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(15).

<sup>94</sup> Commercial Nat. Bank v. Canal-Louisiana B. & T. Co., 239 U. S. 520, 36 S. Ct. 194, 60 L. Ed. 417 (1916).

obtained under a trust receipt, might receive negotiable documents or instruments in full or part payment. If these were to be negotiated by him, would the transferee be given the protection of this section? Fortunately, all these questions are adequately answered by the Act for it declares that documents or instruments taken in substitution for goods, documents, or instruments, or which represent them, or are proceeds thereof, shall be treated in the same manner as those which originally formed the basis of the trust receipt transaction.<sup>95</sup> It is obvious, therefore, that in any one of the supposed cases mentioned above the purchaser of the negotiable instruments or document, if taken in good faith and for value, would not be bound by the entruster's security interest.

### *b. Buyers in the Ordinary Course of Trade*

The Act also limits the entruster's security interest with regard to buyers in the ordinary course of trade. Individuals in this class take free of the latter's security interest where the trustee has been given "liberty of sale," whether such sale takes place within or after the thirty-day period and regardless of filing.<sup>96</sup> As to them, the entruster's security interest is of little consequence, but their rights will depend entirely upon the content given to two terms, *i. e.* "buyer in the ordinary course of trade" and "liberty of sale," so both must be considered at length.

Analyzing the definition of the first term, it may be noted that a purchaser is a "person to whom goods are sold."<sup>97</sup> He must take an interest in the goods, so one acquiring an interest in goods actually displayed and delivered to him as buyer would clearly fit the definition. However, such an interest may also be obtained by the taking of a document of title. If that document of title be a negotiable one, the purchaser's rights may be determined under the preceding sub-section. If the document is of a non-negotiable type,

<sup>95</sup> UTRA § 9-1(b); Ill. Rev. Stat. 1947, Ch. 121½; § 174(1)(b).

<sup>96</sup> UTRA § 9-2(a)(i); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(a)(I).

<sup>97</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(1). The term "person" includes "an individual, trustee, receiver or other fiduciary, partnership, corporation, business trust, or other association and two or more persons having a joint or common interest," according to the section cited. See also Ill. Rev. Stat. 1947, Ch. 121½, § 166(8).

he may still be classed as a buyer in the ordinary course of trade for a sale of paper of this type is, in reality, a sale of the goods it represents. Under this line of reasoning, such a purchaser would also be protected. To be a "buyer," however, there must have been a "sale," a term which indicates the passage of full title as distinguished from the acquisition of only a partial interest. It is for this reason that the definition of such a "buyer" specifically excludes a pledgee, mortgagee, or lienor<sup>98</sup> and, upon the same reasoning, a subsequent entruster or lessee would have no standing under this section for neither acquires a full title to property.

Not every individual obtaining full title by purchase of goods held under a trust receipt is protected. The sale, it should be remembered, must be one arising in the ordinary course of trade. Consistent with this requirement is the exclusion of a transferee in bulk<sup>99</sup> for any transaction whereby substantially all of the trustee's business is purchased is clearly not in the ordinary course of business. But the purpose for which the purchase is made has no effect in determining whether or not the purchase was in the ordinary course of trade. It was argued, in two cases,<sup>1</sup> that an automobile dealer should not be considered a buyer within this term for it had reference only to a private individual purchasing for his own use or consumption and the purchases there made were for resale. The courts refused to make the distinction contended for.

Passage of full title in the usual course of business for value is not alone enough for the Act specifically provides that there must also be delivery of the goods to the buyer.<sup>2</sup> This requisite makes certain that only legitimate vendees will be protected and excludes the possibility of an entruster losing his interest through a transaction which is actually not a sale. The absence of delivery of

<sup>98</sup> Ibid.

<sup>99</sup> A transferee in bulk includes a "mortgagee or a pledgee or a buyer of the Trustee's business substantially as a whole," under UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(13). Compare the expression "substantially as a whole," with the more precise definition of a "bulk sale" to be found in the Bulk Sales Act, Ill. Rev. Stat. 1947, Ch. 121½, § 78.

<sup>1</sup> Colonial Finance Co. v. DeBenigno, 125 Conn. 626, 7 A. (2d) 841 (1939); General Finance Corporation v. Krause Motor Sales, 302 Ill. App. 210, 23 N. E. (2d) 781 (1939).

<sup>2</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(1).

property alleged to have been sold is a fairly positive indication that such was not the case. It will be noted, however, that the Act does not mention whether the vendee has to receive the goods simultaneously with the sale, or whether he may do so subsequently. A requirement for simultaneous delivery might work a hardship where a purchaser makes full payment of the purchase price but is unable to take actual delivery until later. In the meantime, the entruster could repossess the chattels and thus defeat the rights of the vendee. This failure to make a definite stipulation as to when delivery should take place will probably result in the courts concluding that it should take place within a reasonable time after sale. The use of such a test would protect a legitimate purchaser while, at the same time, prevent any collusive transaction from defeating the security interest of the entruster.

A purchaser, in order to be considered a buyer in the ordinary course of trade, must give new value.<sup>3</sup> Fortunately, however, the framers took into account the fact that many sales are made on a credit basis and have specifically provided that such shall constitute a purchase for new value.<sup>4</sup> Aside from this, the definition of "new value"<sup>5</sup> is unsatisfactory. It does not specifically include payment of the purchase price by cash, although this is obviously new value. The only item mentioned in the definition which comes close is the phrase "new advances," but "advances" is hardly a suitable term for denoting payment of a purchase price.<sup>6</sup> This fact led the court, in *Colonial Finance Company v. DeBenigno*,<sup>7</sup> to state: "The Act does not attempt an inclusive definition of new value. It goes no farther than to specify that certain things shall be and other things shall not be regarded as within that term."<sup>8</sup> If this is a true statement as to the actual purpose of the definition, it

<sup>3</sup> Ibid.

<sup>4</sup> UTRA § 9-3; Ill. Rev. Stat. 1947, Ch. 121½, § 174(3).

<sup>5</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(7).

<sup>6</sup> It more nearly means a loan, a gift, or moneys given which are to be repaid: *Vail v. Vail*, 10 Barb. (N. Y.) 69 (1850).

<sup>7</sup> 125 Conn. 626, 7 A. (2d) 841 (1939).

<sup>8</sup> 125 Conn. 626 at 634, 7 A. (2d) 841 at 844. There would appear to be some basis for this contention as UTRA § 1 merely states that "new value" *includes* . . ." followed by a specification of certain items. Italics added.

would appear that any type of consideration, except that which is specifically excluded,<sup>9</sup> would come within the term.

Two courts have already held that since the term does not exclude a pre-existing claim, articles taken in satisfaction thereof have been received for new value. In the first case,<sup>10</sup> a defective automobile was returned, the buyer receiving a credit. Later, this credit was applied upon the purchase of another vehicle which was in the dealer's possession under a trust receipt. It was contended that the purchaser was not a buyer in the ordinary course of trade because he had not given new value. The court, however, held that release of a pre-existing claim or debt was sufficient to support this type of transaction. In the second case,<sup>11</sup> the full purchase price for an automobile was paid upon the expectation that delivery would be made in the near future. The salesman absconded with the funds. The court held that when a new car was accepted by the purchaser in satisfaction of the pre-existing claim against the dealer for the money paid, it constituted the giving of new value. What actually occurred in the above cases was that the purchase price was paid before delivery, but it was no less a payment on the price than if it had been made simultaneously with the delivery. The automobiles received by the purchasers merely constituted the ultimate fulfillment of contracts on which the sellers were bound. It is submitted, however, that if the claims in exchange for which the cars were received had arisen in any other way, the release thereof might not have been considered the giving of new value. The release of a pre-existing debt is specifically included under the other class of consideration termed "value."<sup>12</sup> If such a release also comes within the definition of "new value," the result would be to cloud any intended distinction between the two terms and would eventually lead only to confusion. It is un-

<sup>9</sup> The Uniform Act, Section 1, specifically excludes extensions or renewals of existing obligations or obligations substituted for existing obligations from the definition of new value. The Illinois statute, on the other hand, includes renewals or extensions within the definition: Ill. Rev. Stat. 1947, Ch. 121½, § 166(7).

<sup>10</sup> Colonial Finance Co. v. DeBenigno, 125 Conn. 626, 7 A. (2d) 841 (1939).

<sup>11</sup> Commercial Discount Co. v. Mehne, 42 Cal. App. (2d) 220, 108 P. (2d) 735 (1940).

<sup>12</sup> UTRA § 1; Ill. Rev. Stat. 1947, Ch. 121½, § 166(15).

fortunate, therefore, that the framers were not more explicit so any contemplated change in the Act should include an indication as to whether or not the listing of specific instances under the two definitions is to be considered as exclusive of other instances.

In order to gain the protection afforded by this section, a buyer must also acquire his title to the goods in good faith and without actual notice of any limitations put upon the trustee's right to sell.<sup>13</sup> Only actual notice can defeat the rights of this purchaser, and it has been held that this means actual notice that the article the party is about to purchase is held under a trust receipt. Merely having general knowledge that the seller often acquires property under this type of device is not sufficient.<sup>14</sup>

The common law protected bonafide purchasers from the entruster's secret lien on the basis of estoppel. Some of the earlier courts held that the entruster, by giving possession to a trustee who dealt in this type of property, was estopped without reference to whether or not the right to sell had been given.<sup>15</sup> Others, however, determined that possession had to be coupled with liberty of sale.<sup>16</sup> The framers of the present Act have recognized that the second is the sounder of the two views. The Act makes it necessary that the trustee have the liberty to sell before a purchaser can acquire the property free of the entruster's interest, but indicates that consenting or allowing the goods to be placed in the trustee's stock in trade or in his sales room is to be regarded as equivalent to "liberty of sale."<sup>17</sup> An interesting question arises in this

<sup>13</sup> The requirement of good faith is embodied in the definition of a buyer in the ordinary course of trade: UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(1). The fact that no limitation upon the right to sell is binding upon a purchaser unless he has actual knowledge of such is contained both in the definition of a buyer in the ordinary course of trade and in the section concerning the rights of purchasers: UTRA § 9-2(a) (ii), Ill. Rev. Stat. 1947, Ch. 121½, § 174(2) (a) (II).

<sup>14</sup> Peoples Finance & Thrift Co. of Visalia v. Bowman, 58 Cal. App. (2d) 729, 137 P. (2d) 729 (1943). General knowledge that the party from whom a purchaser was made acquired property under a trust receipt was never sufficient to give him notice at common law: Commercial Credit Co. v. Barney Motor Co., 10 Cal. (2d) 718, 76 P. (2d) 1181 (1938).

<sup>15</sup> General Credit v. Universal Credit, 99 F. (2d) 115 (1938); Tharp v. San Joaquin Valley Securities Co., 20 Cal. App. (2d) 20, 66 P. (2d) 230 (1937); Western States Acceptance Corp. v. Bank of Italy, 104 Cal. App. 19, 285 P. 340 (1930).

<sup>16</sup> Glass v. Continental Guaranty Corporation, 81 Fla. 687, 88 S. 876 (1921); Handy v. C. I. T. Corporation, 291 Mass. 157, 197 N. E. 64 (1935); Clark v. Flynn, 120 Misc. 474, 199 N. Y. S. 583 (1923).

<sup>17</sup> UTRA § 9-2(c); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2) (c).

connection. Suppose the trustee agrees to store the property in a warehouse and not to mingle the merchandise with his own stock but, in breach of the agreement, he retains it at his place of business and sells to a purchaser who in all other respects is a buyer in the ordinary course of trade. There was no consent nor even a conscious allowance of the intermingling. A court faced with this type of problem might well decide for the purchaser on the ground that since the entruster allowed the trustee to take possession he might have foreseen the breach of the argument and the resultant sale to an innocent third party. It is apparent that an entruster allowing articles out of his possession under a trust receipt has little or no protection against buyers in the ordinary course of trade unless the entruster sees to it that suitable tags or other labels are affixed to, and maintained on, the trust receipt property so as to give actual notice of his rights.

As was indicated previously, even if the trustee sells on credit to a buyer in the ordinary course of trade, that individual takes free of the entruster's security interest. This, of course, leaves a debt due and owing on the purchase price. The Act, in effect, subrogates the entruster to the rights of the trustee with respect to this obligation, and also allows him to take possession of any security therefor.<sup>18</sup> While he is thereby given a right of action against the purchaser, it is a limited one, for the entruster is subject to any defense or set-off which accrues before the purchaser becomes aware of the entruster's interest and which he could have exercised as against the trustee.<sup>19</sup> The framers have applied the old undisclosed-principal doctrine to a situation which obviously demands it.<sup>20</sup> It would be inequitable to allow the entruster to recover the unpaid balance of the price where the trustee, had he brought the action, could not have succeeded.

While the framers, in effect, have treated the entruster as an undisclosed principal insofar as is necessary in order that he may

<sup>18</sup> UTRA § 9-3; Ill. Rev. Stat. 1947, Ch. 121½, § 174(3).

<sup>19</sup> Ibid.

<sup>20</sup> It is a generally accepted doctrine that where a third party contracts with an undisclosed agent, he may set off a debt or claim due to him from such agent in a suit by the principal: *Foreign Trade Banking Corporation v. Gerseta Corp.*, 237 N. Y. 265, 142 N. E. 607 (1923).

bring an action against a purchaser in the ordinary course of trade, the same is not true where the purchaser seeks relief because of some breach of contract or warranty arising out of his dealings with the trustee. The Act provides that an entruster "holding a security interest shall not, merely by virtue of such interest or his having given the trustee liberty of sale or other disposition, be responsible as principal or as vendor under any sale or contract to sell made by the trustee."<sup>21</sup> This too is reasonable since, in reality, the entruster is neither principal nor vendor. The purchaser, having dealt with the trustee and not in reliance upon anything said or done by the entruster, should not have the right of action against the latter unless, in fact, the entruster was an undisclosed principal.

*c. Purchasers Not in the Ordinary Course of Trade*

The rights of those obtaining full title to trust receipt property have just been considered. These individuals, it will be remembered, were designated as "buyers in the ordinary course of trade." Another sub-section of the Act covers the rights of those who deal with the trustee in respect to trust receipt property but who do not buy in the ordinary course of trade.<sup>22</sup> It is apparent that the parties falling within the scope of this classification are such persons as pledgees, mortgagees, transferees in bulk, who are expressly excluded from the former category,<sup>23</sup> and also lessees who, though considered purchasers,<sup>24</sup> are not such in the ordinary run of things for they take an interest less than full title. The same reasoning would appear to include a subsequent entruster,<sup>25</sup> and this conclusion is bolstered by the provision that

<sup>21</sup> UTRA § 12; Ill. Rev. Stat. 1947, Ch. 121½, § 177.

<sup>22</sup> UTRA § 9-2(b); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(b).

<sup>23</sup> See definition of "buyer in the ordinary course of trade" as set forth in UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(1).

<sup>24</sup> The term "purchaser" includes anyone acquiring by purchase, and the term "purchase" is defined as a taking, among other things, by lease: UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(10).

<sup>25</sup> The definition of purchaser is broad enough to take into account one acquiring an interest as an entruster, but as he acquires only a security title, he cannot be considered a buyer in the ordinary course of trade. That classification, as has already been seen, applies only to those who obtain full title. The natural conclusion, therefore, is that a subsequent entruster must fall into the class created by UTRA § 9-2(b), Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(b).



where two entrusters become involved with the same property, priorities are to be determined according to the section regulating the rights of purchasers.<sup>26</sup>

As in the preceding sub-section, the provisions of the present one merely make reference to goods, inferentially indicating that a purchaser not in the ordinary course of trade can obtain an interest in only this type of property. If such language were strictly construed, it might be contended that a pledgee of a non-negotiable document, for example, would enjoy no rights under the statute as against the original entruster. However, since a document is merely a document of title to goods,<sup>27</sup> it can be argued quite logically that, by obtaining an interest in such document, a pledgee is acquiring the same sort of interest in the goods represented thereby. If so liberal an interpretation is not desired, some modification of the Act would seem necessary.

There is obvious reason for treating pledgees, mortgagees, transferees in bulk, lessees, or subsequent entrusters in a different fashion than an ordinary consumer who purchases merchandise from a dealer's stock in trade.<sup>28</sup> The former are usually much better acquainted with business practices, are in a position to make inquiry, and are bound by recordation if filing has taken place.<sup>29</sup> If, however, an entruster fails to file, the following rules are declared to apply, to-wit: (1) during the first thirty days, any purchaser not in the ordinary course of trade, except a transferee in bulk, may obtain an interest in the trust receipt property free

<sup>26</sup> UTRA § 2-1; Ill. Rev. Stat. 1947, Ch. 121½, § 167(1).

<sup>27</sup> See definition of "document" set forth in UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(2).

<sup>28</sup> As a general rule, the courts at common law did not extend to the mortgagee of trust receipt property the same protection of the estoppel theory as they gave to a purchaser; *Tropical State Bank v. Sunshine Motor Co.*, 137 Fla. 703, 188 S. 595 (1939); *Globe Securities Co. v. Gardner Motor Co.*, 337 Mo. 177, 85 S. W. (2d) 561 (1935). See also *Moors v. Kidder*, 106 N. Y. 32, 12 N. E. 818 (1887). For a contrary decision, however, see *Monroe v. Philadelphia Warehouse Co.*, 75 F. 545 (1896).

<sup>29</sup> UTRA § 9-2(b); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(b). This would appear to be a simple and understandable provision, yet two courts in deciding for an entruster as against a buyer not in the ordinary course of trade failed to take advantage of the fact that in both instances the buyer took his interest after filing had occurred. Their decisions, while correct, were based upon other grounds. See *C. I. T. Corporation v. Commercial Bank of Patterson*, 64 Cal. App. (2d) 722, 149 P. (2d) 439 (1944); *National Funding Corporation v. Stump*, 57 Cal. App. (2d) 29, 133 P. (2d) 855 (1943).

from the entruster's security interest if he gives new value, acts in good faith, and without notice;<sup>30</sup> (2) after the thirty days have run, any of the above, including a transferee in bulk, can take an interest in the property free from any interest of the entruster merely by giving value.<sup>31</sup> While new value is not necessary, good faith and lack of knowledge are still required.

There is one requirement which is common to all buyers not in the ordinary course of trade and that is that the property must be delivered to the purchaser before the entruster files.<sup>32</sup> This requirement, while consistent with some transactions, is not consistent with others. For instance, a pledgee or lessee would ordinarily take possession of the pledged or leased property, as would also be the case with a transferee in bulk taking full title. On the other hand, an individual acquiring an interest by means of a chattel mortgage or subsequent trust receipt transaction would generally permit the mortgagor or trustee to retain possession of the goods. It would appear that in these latter cases the provisions of the Act do not take into account the distinct characteristics of the several security devices, and to insist upon the requirement of delivery would make it practically impossible for either a mortgagee or subsequent entruster to acquire his interest free from that of the original entruster, even though he acted in good faith and without notice.

#### *d. Purchasers of Non-negotiable Instruments*

It is apparent that none of the provisions of the Act so far discussed have any application to a purchaser acquiring an interest in non-negotiable instruments in the possession of a trustee under a trust receipt. The only sub-section having to do with instruments had reference only to those of negotiable type.<sup>33</sup> It

<sup>30</sup> UTRA § 9-2(b) (i); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2) (b) (I). Unlike the case of creditors, who are also bound by filing, there is no period of grace as to this class of individuals. It behooves an entruster, therefore, to file immediately even though the transaction is to be consummated within a short period of time if he wants protection against purchasers not in the ordinary course of trade other than transferees in bulk.

<sup>31</sup> UTRA § 9-2(b) (ii); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2) (b) (II).

<sup>32</sup> UTRA § 9-2(b); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2) (b).

<sup>33</sup> UTRA § 9-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 174(1) (a).

may have been felt that a transaction involving this kind of paper would never arise, but logic dictates otherwise. For instance, it is not out of the realm of possibility that a non-negotiable bond or other commercial instrument, having been pledged, might be returned to the pledgee under a trust receipt for one of the purposes specified in the Act. That individual, in breach of his agreement, might repledge or sell it to a third party. Any attempt to determine the rights of the entruster, and the third party, by reference to the Act would meet with failure. There is not even a general statement in the Act covering non-negotiable instruments. One thing is known, however, and that is that there are no provisions for filing where an instrument is the basis of a trust receipt transaction. Therefore, any purchaser of this type of interest would not be bound by constructive notice. The Act does provide, however, that for any case not covered by it the general rules of law and equity are to prevail as to trust receipt transactions.<sup>34</sup> Unfortunately, there were no cases prior to the statute involving a purchaser of a non-negotiable instrument held under a trust receipt so reference would have to be made to general rules. The only conclusion that can be drawn is that, in all probability, there being nothing on the face of the non-negotiable instrument to indicate that the holder thereof has it under a trust receipt, anyone buying it or acquiring it in pledge from the trustee-payee would be protected on the basis of estoppel.

### *3. Pledged Property in Possession of Pledgor*

While the Uniform Trust Receipts Act primarily concerns itself with transactions involving the use of trust receipts, it is not confined thereto but also provides for certain types of devices resembling the trust receipt but lacking some of its technical attributes. Among these are pledges, or agreements to pledge, where the property has not been delivered to the pledgee,<sup>35</sup> and cases wherein a person, having a pledgee's interest in goods, documents, or instruments, subsequently delivers them to the

<sup>34</sup> UTRA § 17; Ill. Rev. Stat. 1947, Ch. 121½, § 182.

<sup>35</sup> UTRA § 8-1; Ill. Rev. Stat. 1947, Ch. 121½, § 168(1).

individual having the beneficial interest for "a temporary and limited purpose."<sup>36</sup> Devices of this character might differ from a trust receipt as defined by the Act in that the purposes for which the arrangement was entered into might not correspond to those required for trust receipts,<sup>37</sup> or there might be a failure to take a written instrument evidencing the arrangement.<sup>38</sup>

When any of these allied devices are utilized, a purchaser,<sup>39</sup> including subsequent entrusters, of pledged property without notice and for value takes free from the pledgee's interest provided the pledgor has possession at the time of purchase.<sup>40</sup> The statute does, however, modify earlier doctrines insofar as the rights of creditors of the pledgor are concerned. A pledge with the property in the possession of the pledgor was always valid as against general creditors<sup>41</sup> but became invalid when those creditors attempted to satisfy their claims out of the property.<sup>42</sup> It followed that if the pledge, or contract to pledge, was entered into prior to the four-month period, it did not constitute a preference that could be set aside by a trustee in bankruptcy provided actual delivery or surrender to the pledgee took place some time prior, if only the day before, bankruptcy proceedings were instituted.<sup>43</sup>

The Act makes substantial changes in that rule for a pledge is valid against any creditor of the pledgor for a period of ten days from the time the pledgee has given new value for his in-

<sup>36</sup> UTRA § 3-3; Ill. Rev. Stat. 1947, Ch. 121½, § 168(3).

<sup>37</sup> It will be remembered that UTRA § 2-3, Ill. Rev. Stat. 1947, Ch. 121½, § 167(3), limits the purposes for which a trust receipt transaction may be entered into.

<sup>38</sup> Such a writing is required by UTRA § 2-1, Ill. Rev. Stat. 1947, Ch. 121½, § 167(1).

<sup>39</sup> The term "purchaser" includes one taking by purchase, a mortgagee, a pledgee, or a lessee: UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, §§ 166(10) and 166(11).

<sup>40</sup> UTRA § 3-2; Ill. Rev. Stat. 1947, Ch. 121½, § 168(2). That provision is nothing more than a restatement of the common law doctrine that a pledgee without possession had no standing against third parties: *Robertson v. Wade*, 17 Tenn. App. 457, 68 S. W. (2d) 487 (1934).

<sup>41</sup> *Johnson v. Burke Manor Bldg. Corporation*, 48 F. (2d) 1031 (1931); *Gamson v. Pritchard*, 210 Mass. 296, 96 N. E. 715 (1911); *Garrison v. Vermont Mills*, 154 N. C. 1, 69 S. E. 743 (1910).

<sup>42</sup> *Peoples Bank v. Continental Supply*, 213 Ky. 44, 230 S. W. 458 (1926); *Rowell v. Claggett*, 69 N. H. 201, 41 A. 173 (1897); *Ackerson v. Babcock*, 132 Wash. 435, 232 P. 335 (1925).

<sup>43</sup> *In re Automobile Livery Service Co.*, 176 F. 792 (1910); *McDonald v. Aetna Indemnity Co.*, 90 Conn. 415, 97 A. 332 (1916); *Davis v. Billings*, 254 Pa. 574, 99 A. 163 (1916).

terest,<sup>44</sup> so no creditor, whether with or without notice of the pledge, who attempts to levy upon the pledged property within that ten-day period has any standing as against the pledgee. Short term advances, often beneficial and necessary in commercial dealings, are thereby made possible even though delivery of the pledged property may, for some reason, be delayed. After the ten-day period has lapsed, or in cases where the pledge is based simply upon value and not new value, the pledgee has no protection against the pledgor's lien creditors<sup>45</sup> without notice unless he perfects his pledge by taking possession of the property.<sup>46</sup> Even then, such possession does not relate back to the time the agreement to pledge was entered into,<sup>47</sup> so it is no longer possible for a pledgee who takes possession of the property within the four-month period prior to bankruptcy to argue that such transfer should not be set aside as a preference merely because the agreement was entered into before that period.

#### D. ENTRUSTER'S RIGHT TO PROCEEDS

It has been necessary to postpone more than incidental consideration to the problem of the entruster's right to the proceeds arising from the trust receipt property until after full consideration of the operation of the trust receipt device not only as between the immediate parties but also as to third persons. Having considered that operation as it dealt with the specific property

<sup>44</sup> UTRA § 3-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 168(1)(a).

<sup>45</sup> "Lien creditors" are those who have obtained a specific lien through attachment, levy, or other judicial process, including distraint for rent, according to UTRA § 1, Ill. Rev. Stat. 1947, Ch. 121½, § 166(6). The section under consideration, speaking of lien creditors, makes specific reference to those who "become such as prescribed in section 8." That section declares that a lien creditor becomes such when the process is issued: UTRA § 8-3(a). There is no comparable provision in the Illinois statute, but see above for a discussion of this problem as it concerns Illinois creditors.

<sup>46</sup> UTRA § 3-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 168(1)(b). An interesting problem arose in *Gins v. Mauser Plumbing Supply Co.*, 148 F. (2d) 974 (1945). The defendant obtained an interest as a pledgee in property which was in the possession of a prior pledgee. That individual agreed to deliver this security to the defendant as soon as his own debt was paid. The court held that the pledge to the defendant was perfected at the time it was made, although he did not take actual possession. What really happened was that the possession of the first pledgee inured to the benefit of the second; therefore the pledge could not be set aside as a preferential transfer under the Bankruptcy Act.

<sup>47</sup> UTRA § 3(1)(b), Ill. Rev. Stat. 1947, Ch. 121½, § 168(1)(b), contains a specific declaration on the point.

entrusted, it is now possible to examine the situation as it affects proceeds arising therefrom. One important feature of the trust receipt is that it makes possible a "self-liquidating" debt particularly when the security for the obligation is placed in the possession of the trustee with liberty to sell or dispose of it. From the point of view of the entruster, this can be extremely beneficial provided he can, in some manner, control the proceeds after they reach the hands of the trustee. To this end, the entruster invariably embodies a provision in the trust receipt making it mandatory upon the trustee to turn all such proceeds over to him.<sup>48</sup> Unless this provision is subsequently waived, there can be no question as to its binding effect upon the trustee, but whether it will be sufficient to prevent creditors of that individual from levying on or attaching these assets while still in the trustee's possession is another question. Since these proceeds might take the form of other goods or negotiable paper, it might also become important to protect the same against purchasers who might attempt to acquire an interest therein. It being important to the entruster that his security interest in the original property should attach to the proceeds thereof, the Act, in its usual complicated manner, seeks to afford him a measure of protection in that direction also.

The pertinent section purports merely to protect those entrusters who have not given the liberty of sale or those who, having conferred this right, require that the trustee account for the proceeds.<sup>49</sup> It is obvious that should the entruster fail to reserve the right to demand an accounting at the outset or subsequently waive such privilege, he cannot claim the benefits thereof. It is important, therefore, to determine under what circumstances such a waiver can materialize. The Uniform Act specifically provides that this prerogative may be surrendered either by word or conduct, and the failure to demand an accounting within ten days after the entruster has been apprised of the fact that proceeds do exist constitutes a waiver.<sup>50</sup> This clause has been omitted from

<sup>48</sup> See, for example, the forms used in *B. C. S. Corporation v. Colonial Discount Co.*, 169 Misc. 711, 8 N. Y. S. (2d) 65 (1938).

<sup>49</sup> UTRA § 10; Ill. Rev. Stat. 1947, Ch. 121½, § 175.

<sup>50</sup> UTRA § 10(c).

the Illinois statute, however, so mere inaction on the entruster's part cannot deprive him of his reserved right in the proceeds although he can undoubtedly surrender such privilege. A waiver of the right to demand an accounting would unquestionably inure to the benefit of attaching creditors and other third parties and it might also have a profound effect upon the rights of the trustee. Of course, by no stretch of the imagination, could such a waiver free him from the obligation of the indebtedness owed to the entruster, but it would make it possible for him to deal with the specific proceeds as he saw fit without the necessity for turning the same, in kind, over to the entruster.<sup>51</sup>

Presumably no alert entruster will suffer such surrender of his right either by words, conduct, or delay, hence it is essential to determine the scope of the right provided by this section. It cannot be emphasized too strongly that he is not given an unlimited right to those proceeds even though he attempts to reserve such. His claim to them is only recognized to the extent that, and as to those individuals against whom, his security interest in the trust receipt property was valid at the time of its disposal.<sup>52</sup> This is only equitable for it would be manifestly unjust to permit him to claim the proceeds arising from goods, documents, or instruments in which he did not have a valid security interest. It will be remembered, however, that as to some individuals the entruster's security interest is never valid, and it would logically follow that the entruster could not have any claim to the proceeds as against this class of persons. To fully understand the significance of this provision, it is necessary to apply it to practical illustrations.

The most likely controversy to arise with respect to proceeds from the sale of property held under trust receipt is where individual lien creditors or general creditors represented by a trustee in bankruptcy or a receiver attempt to satisfy their claims out of these assets. It will be remembered that the entruster's security interest in the specific property is valid as against all creditors

<sup>51</sup> There has been no attempt made to consider whether a prosecution for embezzlement or larceny by bailee would lie. The provisions of Ill. Rev. Stat. 1947, Ch. 121½, § 183, would be inapplicable because of the waiver.

<sup>52</sup> UTRA § 10; Ill. Rev. Stat. 1947, Ch. 121½, § 175.

of the trustee for thirty days without filing and for a specified period thereafter if prompt filing takes place. If the property should be sold at any time during this period of validity, the security interest would attach to the proceeds and none of the creditors could satisfy their debts out of any accounts receivable, funds, or property received in part or full payment of the purchase price. Conversely, if the sale had been consummated after the thirty-day period of grace but before filing, the creditors without notice would now prevail over the entruster in regard to the proceeds, as the disposition took place at a time when the latter's security interest was invalid.

Once determining that the entruster has a right to the proceeds, it must be considered to what extent he can enforce that right against the assets in the hands of a receiver or trustee in bankruptcy. The common law limitation that he had to be able to identify the proceeds<sup>53</sup> has been modified somewhat by the Act. If he can show that the proceeds from a sale were received by the trustee within ten days of (1) the appointment of a receiver or the filing by or against the trustee of a petition in bankruptcy or judicial insolvency, or (2) a demand by the entruster for a prompt accounting, he may receive the value of such proceeds even though they are not identifiable.<sup>54</sup> It is true that whether or not the proceeds are received by the trustee within ten days of insolvency or the filing of such petitions is beyond the control of the entruster, but by making a demand for an accounting within ten days of the time the trustee acquires the proceeds, he can insure himself of a preference as against the general assets of that individual, even though the bankruptcy or insolvency takes place subsequent to the ten-day period. It will be noted that, unlike the period in respect to waiver, this ten days starts running not from the time when the entruster obtains knowledge of the existence of the proceeds, but rather from the trustee's actual receipt thereof. Thus, it is important that the entruster stay in close touch with developments in order that he be able to make prompt demand for an accounting.

<sup>53</sup> *Vaughan v. Massachusetts Hide Corporation*, 209 F. 667 (1913) ; *In re Mulligan*, 116 F. 715 (1902).

<sup>54</sup> UTRA § 10(b) ; Ill. Rev. Stat. 1947, Ch. 121½, § 175(b).



There may be occasions where the trustee receives a negotiable instrument or even a negotiable document as part of the proceeds of a sale. These might be sold or pledged by him, and the problem presents itself as to whether or not the entruster could enforce his right to these proceeds against the purchaser or pledgee. This, of course, depends upon the validity of the entruster's security interest as to this class of individuals. Generally, purchasers of such paper, giving value and taking without notice, would acquire the property free of the entruster's interest even if there had been a filing.<sup>55</sup> It follows, therefore, that the entruster cannot claim the proceeds against these individuals and this inescapable conclusion is verified by another section of the Act which specifically states that any purchaser of negotiable paper, even though obtained by the trustee as proceeds of goods, documents, or instruments, acquires his interest free from that of the entruster.<sup>56</sup>

As often happens in the case of automobile transactions, which make up a substantial portion of trust receipt financings, the dealer possessed of cars under a trust receipt may sell one, take the purchaser's old vehicle in trade, and then sell that too. The used car would certainly be considered part of the proceeds of the original sale, so questions will arise over the extent to which the entruster's right to proceeds will attach to it. If the individual buying the traded-in automobile possessed all the requisites of a buyer in the ordinary course of trade, the entruster's right to the proceeds could not be enforced for his security interest is never valid against such a party,<sup>57</sup> but if the purchaser lacked any of the elements of a buyer in the ordinary course of trade his right to the used automobile would have to yield to those of the entruster.

Under a similar set of circumstances, it might occur that the transferee of the trustee, instead of purchasing the traded-in article outright, acquires some lesser interest in it, either as a mortgagee, pledgee, lessee, or subsequent entruster. Here again

<sup>55</sup> UTRA § 9-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 174(1)(a).

<sup>56</sup> UTRA § 9-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 174(1)(b).

<sup>57</sup> UTRA § 9-2(a); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(a).

the status of the parties must be determined in the light of the entruster's security interest at the time the trustee sold the original article. Not being purchasers in the ordinary course of trade, if the original sale had taken place after there had been a filing, they could acquire no rights in the proceeds, since at that time the entruster's security interest was valid against them.<sup>58</sup> The decision in the California case of *Peoples Finance & Thrift Company of Visalia v. Bowman*,<sup>59</sup> however, would appear to refute this conclusion. In that case a dealer acquiring an automobile under a trust receipt sold it, taking a secondhand car in part payment. The plaintiff advanced money on this car under a subsequent trust-receipt transaction. Upon learning of this, the original entruster seized the vehicle and precipitated an action by the plaintiff. The court decided for the plaintiff, basing its decision on an estoppel theory, by indicating that since the plaintiff did not have actual notice of the defendant's prior trust receipt or his right to the proceeds, he should not be bound by either. From the facts of the case, it would appear that the original entruster had filed in accordance with the Act and, therefore, presumably his security interest should have been valid as against any subsequent entruster<sup>60</sup> and ought to have attached to the proceeds of any sale as against such an individual. The decision appears erroneous and probably indicates a lack of understanding of this section engendered by its complexity. There are periods, however, during which a purchaser not in the ordinary course of trade is not bound by an entruster's security interest,<sup>61</sup> so, if the trustee has disposed of the trust receipt property during these periods, it would follow that this type of purchaser would obtain as valid an interest in the proceeds thereof as he could have obtained in the property itself.

<sup>58</sup> The entruster's security interest is always valid as against purchasers other than buyers in the ordinary course of trade where he has filed in accordance with the Act: UTRA § 9-2(b), Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(b).

<sup>59</sup> 58 Cal. App. (2d) 729, 137 P. (2d) 729 (1943).

<sup>60</sup> An entruster obtaining a security interest in property which is already held under a trust receipt is considered a purchaser not in the ordinary course of trade. See above for a discussion of this point.

<sup>61</sup> UTRA § 9-2(b); Ill. Rev. Stat. 1947, Ch. 121½, § 174(2)(b).

## E. NOTICE REQUIREMENTS

Some emphasis has already been given to the fact that the entruster, to preserve his interest in the trust receipt property, should give notice of his rights. In that regard, it will be remembered that the public recording requirements for both the chattel mortgage and the conditional sale contract were considered to be drawbacks to the utilization of such devices first, because each separate transaction had to be filed, resulting in inconvenience and expense; second, any person interested had to gear his operations to the delay made necessary to complete a search of existing records; and third, information concerning the debtor's financial conditions, usually kept secret by the debtor if possible, was publicized. When the framers of the Act decided to require recordation in the case of trust receipts, they attempted to obviate these difficulties yet still provide an adequate source of information for third parties so that they would not be harmed by lack of actual knowledge of the debtor's operations. With this in mind, the filing procedure established makes it unnecessary to record each trust receipt transaction, for the single filing of a statement to the effect that the entruster is engaged in, or intends to engage in, trust receipt activities with a named trustee is deemed sufficient warning. This statement is designed to cover all individual transactions entered into between the parties for a period of one year. Recordation of this type is sufficient to permit any individual to ascertain whether or not a given party utilizes the trust receipt device to obtain possession of property, and the type of property so covered; hence, armed with this much information he is in a position to deal with the trustee accordingly.<sup>62</sup>

As the statement referred to is intended to cover several trust receipt transactions, it is apparent that in some cases the filing will occur before new value is given. This raises the question of whether the entruster's security interest, once obtained, dates

<sup>62</sup> The filing provisions are only applicable to trust receipt transactions involving goods or documents. Recordation is apparently deemed unnecessary in the case of instruments for the entruster, by making appropriate notations upon such paper, can bring his security interest to the attention of any third party intending to deal therewith.

from the time of filing or from the time the new value is given. In the Illinois case of *Donn v. Auto Dealers Investment Company*<sup>63</sup> the court was asked to determine the effect of filing before actual credit advances were made. Both the plaintiff and the defendant therein were automobile financiers. Each had filed the requisite statement under the Act showing an intention to engage in transactions with the same dealer, the plaintiff's filing being prior to that of the defendant. The defendant financed the purchase of certain automobiles for this dealer and, subsequently, the plaintiff made credit advances on the same vehicles. In an action between the two, the only question raised was as to which held the prior security interest. The Appellate Court ruled that the plaintiff acquired an inchoate security interest from the time his statement was filed and, as soon as credit was given, it ripened into an actual lien which related back to the time of the original filing. That decision was reversed by the Illinois Supreme Court, however, which court held that the date when the security interest attaches is to be determined not by recordation but by the actual advancement of credit; hence it gave priority to the defendant who came on the scene later but was the first person to give actual value.

The statement to be filed should be signed by both entruster and trustee and should then be enrolled with the Secretary of State or some comparable state officer,<sup>64</sup> which central filing system serves the convenience of those who are bound by the constructive notice.<sup>65</sup> The form to be used is simple,<sup>66</sup> requires only a minimum of information and reveals little or nothing which might provide advantage to the trustee's competitors. The statement should contain: (1) the name of the entruster and trustee together with the principal place of business of each, within or

<sup>63</sup> 318 Ill. App. 95, 47 N. E. (2d) 568 (1943), reversed in 385 Ill. 211, 52 N. E. (2d) 695 (1944), noted in 22 CHICAGO-KENT LAW REVIEW 99 and 145.

<sup>64</sup> UTRA § 13-1; Ill. Rev. Stat. 1947, Ch. 121½, § 178(1).

<sup>65</sup> In Pennsylvania, the filing must be both with the Department of State and the Prothonotary of the county in which the trustee's principal place of business is located: Purdon's Pa. Stat. Anno., Tit. 68, § 563-1.

<sup>66</sup> UTRA § 13-2, Ill. Rev. Stat. 1947, Ch. 121½, § 178(2), provides a form which may be used. It is not mandatory.

outside the state;<sup>67</sup> (2) a statement that the entruster "is engaged, or expects to be engaged, in financing under trust receipt transactions the acquisition of goods" by the trustee;<sup>68</sup> and (3) a description of the goods financed.<sup>69</sup>

The filing officer is directed, by the statute, to index the statement according to the name of the trustee, and to note the date and hour of filing.<sup>70</sup> Presentment for filing together with payment of the fee is considered equivalent to recording,<sup>71</sup> despite the claim made in one case that, because the trust receipt statement did not bear the required file-mark, it was to be deemed a nullity.<sup>72</sup> It would also seem that the filing would be equally good even though, through some dereliction of duty on the part of the filing officer, the statement might never be catalogued. While the filing is effective for one year,<sup>73</sup> there may be a refiling at the expiration of that term either by the recording of another statement or by an affidavit, signed by the entruster, containing the same information required in the original statement.<sup>74</sup>

If the trust receipt should come within the purview of some other recording statute, the entruster is not burdened by the necessity of complying with both statutes but has an election.<sup>75</sup>

<sup>67</sup> UTRA § 13-1(a); Ill. Rev. Stat. 1947, Ch. 121½, § 178(1)(a). It is thereby made possible for anyone desiring to deal with the trustee to communicate with the entruster and inquire directly as to the nature of the entruster's interest, if any. He need not rely on an affidavit of the trustee, as is the case under the Bulk Sales Act.

<sup>68</sup> UTRA § 13-1(b); Ill. Rev. Stat. 1947, Ch. 121½, § 178(1)(b). The term "acquisition of goods" would indicate that this type of security device is only to be utilized in the financing of new purchases and not in obtaining advances upon old inventories in the trustee's possession.

<sup>69</sup> UTRA § 13-1(c); Ill. Rev. Stat. 1947, Ch. 121½, § 178(1)(c). This information would necessarily have to be of a general character since the statement may cover transactions entered into during a full year. A description by serial, style, or model number would usually be impossible for, at the time of filing in advance, the exact items to be acquired by the trustee generally are not known. See the generality of the language used in *In re Chappell*, 77 F. Supp. 573 (1948).

<sup>70</sup> UTRA § 13-3; Ill. Rev. Stat. 1947, Ch. 121½, § 178(3).

<sup>71</sup> UTRA § 13-4; Ill. Rev. Stat. 1947, Ch. 121½, § 178(4).

<sup>72</sup> *Middleton v. Commercial Inv. Corporation*, 301 Ill. App. 242, 22 N. E. (2d) 723 (1939).

<sup>73</sup> UTRA § 13-4; Ill. Rev. Stat. 1947, Ch. 121½, § 178(4).

<sup>74</sup> UTRA § 13-5; Ill. Rev. Stat. 1947, Ch. 121½, § 178(5), declares: "Any filing of such further statement or affidavit shall be valid in like manner and for like period as an original filing, and shall also continue the rank of the Entruster's existing security interest as against all junior interests."

<sup>75</sup> UTRA § 16; Ill. Rev. Stat. 1947, Ch. 121½, § 181.

There are several types of statutes under whose filing provisions a trust receipt might conceivably fall. At common law it was held that the general recording acts of some states were broad enough in scope to cover a tri-partite transaction.<sup>76</sup> Since, under the present statute, a bi-partite arrangement is also recognized, filing requirements for chattel mortgages or conditional sales contracts might be considered applicable, even though the trust receipt lacks some of their technical aspects. The entruster, however, obtains no further protection by adhering to a different recording statute, since those individuals not bound by filing under the Uniform Trust Receipts Act are not to be bound by recording under any other act.<sup>77</sup> It might be said, therefore, depending upon the terms of individual statutes, that the only differences between filing under the Uniform Trust Receipts Act in contrast to proceeding under general recording laws will have to do with the extent of the information required and the period for which the recording is effective. The simplicity of the former, to say the least, counts in its favor.

#### F. MISCELLANEOUS PROVISIONS

Brief attention should be given to certain miscellaneous provisions of the Act not capable of treatment elsewhere. It contains the customary provision that it shall not operate retroactively and that it shall only govern transactions entered into after its effective date.<sup>78</sup> The importance of the effective date was brought out vividly in a case decided by a federal court sitting in Massachusetts.<sup>79</sup> Prior to the adoption of the Act, that state had regarded an unrecorded trust receipt in the same light as an unrecorded chattel mortgage.<sup>80</sup> The question came up as to the validity of unrecorded trust receipts against a trustee in bankruptcy. Some of the trust receipts were executed before,

<sup>76</sup> *In re Bettman-Johnson Co.*, 250 F. 657 (1918).

<sup>77</sup> UTRA § 16; Ill. Rev. Stat. 1947, Ch. 121½, § 181.

<sup>78</sup> UTRA § 21; Ill. Rev. Stat. 1947, Ch. 121½, § 186. The statute became effective in Illinois on July 1, 1935.

<sup>79</sup> *In re McManus Motors*, 27 F. Supp. 113 (1939).

<sup>80</sup> *Hartford Accident & Indemnity Co. v. Callahan*, 271 Mass. 556, 171 N. E. 820 (1930).

others after, the effective date. The court came to the obvious conclusion that those made before were invalid for failure to record, but the later ones were to be upheld.

A companion provision states that the Act should control notwithstanding any other laws,<sup>81</sup> thereby serving to repeal all conflicting laws. It was accordingly argued, in the case of *In re Boswell*,<sup>82</sup> that the Act had, by implication, annulled several other statutes dealing with liens and mortgages. In support thereof it was urged that as the new Act permitted secret liens, the trust receipt would become so popular that the more cumbersome devices such as the mortgage or pledge would no longer be utilized. The court pointed out that the Act merely controlled trust receipts, did not actually or by implication repeal laws relating to other security devices, and the mere fact that mortgages and pledges might not be employed as extensively as theretofore could not be construed to be a statutory restriction on their use.

The Act bears two separate titles, the short or popular title used for reference purposes<sup>83</sup> and the more formal title appearing as the heading which, under most state constitutions, should fairly express the substance of its contents.<sup>84</sup> Both have been the object of criticism. One writer has condemned the use of the phrase "Uniform Trust Receipts Act," claiming that it was meant to cover up what, in his opinion, were certain undesirable features of the statute.<sup>85</sup> He made particular reference to the inclusion of bi-partite transactions resembling chattel mortgages under the heading of trust receipts,<sup>86</sup> and contended that certain of the legislatures would not have enacted the Uniform Act if they had realized its true significance even though the rules governing trust receipts were admittedly in need of reform.

<sup>81</sup> UTRA § 21; Ill. Rev. Stat. 1947, Ch. 121½, § 186.

<sup>82</sup> 96 F. (2d) 239 (1938), affirming 20 F. Supp. 748 (1937).

<sup>83</sup> UTRA § 20; Ill. Rev. Stat. 1947, Ch. 121½, § 187.

<sup>84</sup> See, for example, Ill. Const. 1870, Art. IV, § 13.

<sup>85</sup> See Layton, "Beware of Laws Called Uniform," 40 Credit & Finan. Management 21 (1938).

<sup>86</sup> The feeling among many was that trust receipt financing should be confined to tri-partite transactions as originally developed under the common law. The inclusion of bi-partite arrangements was the reason the Act received opposition from many quarters: 146 Com. and Fin. Chron. 2781 (1938).

The longer title has been attacked, on constitutional grounds, in two cases arising in California.<sup>87</sup> The title of the statute there concerned purported to deal with trust receipts and pledges of personal property accompanied by possession. The argument was advanced that the Act, in reality, permitted secret liens and also repealed certain laws having to do with pledges and mortgages, points not set out in the heading. No constitutional objection was found to exist when the court pointed out that the term "trust receipt" had always been associated with mortgages, unrecorded liens, and pledges, thus embodying all of these items. The title to the Illinois Act is even broader in scope,<sup>88</sup> and it would seem reasonably safe to say that there can be little argument as to its sufficiency.<sup>89</sup>

The Illinois statute embodies a section not found in the Uniform Act, one which declares that it is a felony for a trustee to dispose of goods, documents, or instruments held under a trust receipt and to fail to pay the amount of the debt where he either had no liberty to make such disposition or, having it, was under an obligation to account for the proceeds.<sup>90</sup> There is no record of a conviction under its provisions.

### III. CONCLUSION

The object of the foregoing analysis has been of a two-fold character: (1) to promote a clearer understanding of an act which, because of its highly technical subject matter, has long remained obscure to many; and (2) to point out the parts which need clarification in the hope that they will be considered in any

<sup>87</sup> In *re Boswell*, 96 F. (2d) 239 (1938), affirming 20 F. Supp. 748 (1937); *Chichester v. Commercial Credit Co.*, 37 Cal. App. (2d) 439, 99 P. (2d) 1083 (1940).

<sup>88</sup> Ill. Rev. Stat. 1947, Ch. 121½, § 166, declares it to be an act "concerning trust receipts and certain security transactions and to make uniform the law relating thereto." The term "security transactions" would appear to be broad enough to cover all provisions embodied in the statute, as well as devices not encompassed thereby.

<sup>89</sup> In *Middleton v. Commercial Inv. Corporation*, 301 Ill. App. 242, 22 N. E. (2d) 723 (1939), an attack upon constitutionality seems to have been predicated on these grounds, but the Appellate Court noted that the contention was merely stated in the brief, was not argued, and had been waived. Anyway, the question of constitutionality should have gone directly to the Illinois Supreme Court.

<sup>90</sup> Ill. Rev. Stat. 1947, Ch. 121½, § 183.



future revision. No comment has been made concerning either the phraseology or the format of the statute. It is obvious to anyone who has examined its provisions that the Act is couched in a language which is none too clear, even to one versed in the subject, and contains many dependent clauses the true import of which cannot be gathered at a single reading. It goes without saying that, in any revision of the Uniform Trust Receipts Act for the purpose of its inclusion in a contemplated commercial code, those commissioned to do the work of redrafting will face an unenviable task. They should keep foremost in mind, however, that no future recodification will be of any value unless it serves to simplify the law so that even a businessman can understand it.<sup>91</sup>

<sup>91</sup> Beers, "The New Commercial Code," 2 *Bus. Lawyer* 14 at 17 (1948), states: "A commercial code is not just for lawyers. The merchant, the banker, and the ordinary man have a right to have ordinary transactions governed by laws they can understand."

## NOTES AND COMMENTS

### Do "TAX CONSULTANTS" PRACTICE LAW?

There has recently come from the Appellate Division of the New York Supreme Court, through the medium of the decision in *Application of New York County Lawyers Association*,<sup>1</sup> as succinct a statement of the doctrine *juris consultis interpretatio juris*<sup>2</sup> as has yet been announced by any court. In meaning, that statement is as certain and exact as the doctrine of *stare decisis*; in operation, it should prove as lasting and helpful. Without doubt, for New York, it answers the question posed above.

The origin of that decision lay in the fact that a New York corporation, which had not shown any profit for three years and had not paid its sales and compensating use taxes due the state, suddenly made so much money that it was faced with the prospect of having to pay a large federal income tax. The question arose as to whether the payment, in the current year, of the past due sales and use taxes would support deduction by the taxpayer of the amount thereof from the current large profit. The company's accountant, who was also a lawyer, advised against any such deduction. It was then that the company called upon one Bercu, a certified public accountant, and requested his advice. He was not asked to audit any books or prepare any tax returns but was simply asked the abstract question: Does the law permit the taking of this deduction in the current year? He answered the question, charged the company for his advice,<sup>3</sup> and when the company did not pay he sued. Recovery was denied on the ground that Bercu had engaged in the unauthorized practice of law. Thereafter, the New York County Lawyers Association applied to the court to punish Bercu for his contempt as well as to enjoin against his unauthorized practice in the future. Although the initial tribunal denied relief, substantially on the theory that the giving of tax advice was proper tax accounting practice, the Appellate Division, by a divided vote, imposed a fine and issued the injunction. The majority declared that when an accountant passes on a question of law, apart from auditing books or preparing tax returns, he is engaging in the unauthorized practice of law.

<sup>1</sup> Sub nom. *In re Bercu*, 273 App. Div. 524, 78 N. Y. S. (2d) 209 (1948), reversing 188 Misc. 406, 69 N. Y. S. (2d) 730 (1947). Glennon, J., dissented. It is understood that the case is now pending before the New York Court of Appeals.

<sup>2</sup> That maxim may be said to mean that interpretation of the law is the province of lawyers.

<sup>3</sup> What that advice was is immaterial to this discussion.

Considering, as a matter of public benefit, whether accountants ought to be entrusted to engage in the abstract interpretation of laws, attention is first directed to differences in education and training between attorneys and accountants. A survey shows that in at least forty states the general educational requirement for the lawyer is a minimum of two years of prelegal training at the college level as opposed to a maximum requirement of only a high school education for the accountant. In over a fourth of the American states, admission to the bar also demands a minimum of three years of law school study, covering every branch of the law, as compared to only two states which require any specialized college training for the certified public accountant.<sup>4</sup> Much more significant, however, is the fact that the scope of the education and training of the great body of self-styled "accountants" or "tax consultants" is absolutely unspecified and uncontrolled. They are on their own and all is fish that falls in their nets. To allow such persons, who have not made a study of the whole body of the law, with its correlated system of statutes and decisions, to interpret statutes would be as absurd as to permit persons who lack a study of the whole human body to operate on the human anatomy.<sup>5</sup>

It must also be remembered that, in order to protect the public against ill-considered interpretations of the law leading to wholesale litigation, attorneys, made officers of the courts by the solemn judicial act of admission to the bar, are responsible directly for moral or professional misconduct. No matter how fine the education and training of accountants might grow to be, they still will not be, and cannot be, under the direct disciplinary control of the courts. Except by enforcing liability for malpractice after the event, there is no way by which the courts can impose upon the laymen the same high standards enforced among members of the bar. For that matter, no accountant is subject to discipline for adver-

<sup>4</sup> See Exhibit Four appended to statement of W. McNeil Kennedy, representing the Chicago Bar Association, on H. R. 3214, made before the Senate Judiciary Committee. That measure, as originally introduced, represented the considered opinion of experts and had the approval of many bar associations. Among other things, it was designed to make the Tax Court, now an administrative body, into a court of the United States. On July 7, 1947, with debate limited, Section 2560 thereof was amended to read: "No qualified person shall be denied admission to practice before such Court because of his failure to be a member of any profession or calling." Necessarily, as amended, the bill was then opposed by the bar associations because it would operate to admit laymen to practice before a court in violation of a principle, firmly rooted in law, that only lawyers shall represent others in courts of record: *Osborn v. United States Bank*, 9 Wheat. 738, 6 L. Ed. 204 (1824), *Robb v. Smith*, 4 Ill. 46 (1841). The sponsors of the amendment refused to concede this principle so the Senate, in order to insure passage of the bill as a whole, struck out all provisions designed to convert the Tax Court into a judicial body. It remains, therefore, an administrative agency. It is probable, however, that its method of operation will have to be changed to meet the requirements of the Administrative Procedure Act, in accordance with the decision in *Lincoln Electric Co. v. Commissioner*, 162 F. (2d) 379 (1947), unless change is made in the law.

<sup>5</sup> *Walker v. Kahn*, 31 Pa. D. & C. 620 (1938).

tising or soliciting employment, while members of the bar are prohibited from both of these practices.

In still other important respects, the law treats lawyers differently than accountants. The client, when consulting a lawyer, is generally protected in his right to make free disclosure by treating his communications to his lawyer as privileged.<sup>6</sup> Except as provided by statute,<sup>7</sup> communications to accountants are not so privileged. The security of the confidential relationship, found between attorney and client, may often be an important element in consultations over tax matters; its absence, when the accountant is called upon, may be productive of mischief. By and large, the lawyer's main duty is to advocate his client's cause. The predominant characteristic of a certified public accountant, on the other hand is his independence or objectivity. Advocacy and objectivity are diametric opposites. For these reasons, then, to allow laymen accountants to engage in formulating abstract interpretations of laws would open the door to the same irresponsibility that has jeopardized public welfare by other forms of unauthorized practice.<sup>8</sup>

<sup>6</sup> The history of privileged communications between attorney and client is almost as ancient as the legal profession: Wigmore, *Evidence*, 3d Ed., Vol. 8, § 2290.

<sup>7</sup> Statutes on the subject may be found in Colo. Stats. 1929, Ch. 185, p. 642, Ga. Stats. 1943, Tit. 84, § 84-216, Ill. Rev. Stats. 1947, Ch. 110½, § 19, Iowa Code 1931, § 1905-c-17, Ky. Stats. 1946, Ch. 210, § 20, and N. M. Stats. 1941, § 20-112(e). Others may be in the course of promulgation: Wigmore, *op. cit.*, § 2286, n. 14.

<sup>8</sup> The following cases illustrate other acts held to amount to unauthorized practice of law: *People v. Tinkoff*, 399 Ill. 282, 77 N. E. (2d) 693 (1948), conduct of litigation by disbarred attorney; *People ex rel. Chicago Bar Association v. Goodman*, 366 Ill. 346, 8 N. E. (2d) 941, 111 A. L. R. 1 (1937), appearance of layman before Industrial Commission; *People ex rel. Chicago Bar Association v. Chicago Motor Club*, 362 Ill. 50, 199 N. E. 1 (1935), legal services capitalized for profit; *People ex rel. Chicago Bar Association v. The Motorists Association of Illinois*, 354 Ill. 595, 188 N. E. 827 (1933), association rendering legal service to members; *People ex rel. Courtney v. Association of Real Estate Taxpayers*, 354 Ill. 102, 187 N. E. 823 (1933), lay intermediary between lawyers and their clients; *People v. Schreiber*, 250 Ill. 345, 95 N. E. 189 (1911), fraudulent misrepresentation as to license to practice; *People v. Securities Discount Corporation*, 361 Ill. 551, 198 N. E. 681 (1935), collection agency practicing law; *People ex rel. Illinois State Bar Association v. Stock Yards State Bank*, 344 Ill. 462, 176 N. E. 901 (1931), corporation practicing law; *Smith v. Illinois Adjustment Finance Co.*, 326 Ill. App. 654, 63 N. E. (2d) 264 (1945), same; *Chicago Bar Association v. United Taxpayers of America*, 312 Ill. App. 243, 38 N. E. (2d) 349 (1941), certified public accountant and corporation practicing before Department of Finance; *Midland Credit Adjustment Co. v. Donnelly*, 219 Ill. App. 271 (1920), collection agency practicing law; *Bump v. District Court*, 323 Iowa 623, 5 N. W. (2d) 914 (1942), layman presenting tax refund claims; *N. Y. County Lawyers Ass'n v. Dawkins*, 262 App. Div. 56, 27 N. Y. S. (2d) 797 (1941), affirmed in 289 N. Y. 553, 43 N. E. (2d) 530 (1942), appearance before Board of Assessors; *People ex rel. Trojan Realty Co. v. Purdy*, 174 App. Div. 702, 162 N. Y. S. 56 (1916), presentation of tax protests; *In re Standard Tax & Management Corp.*, 181 Misc. 632, 43 N. Y. S. (2d) 479 (1943), giving of tax law advice; *Mandelbaum v. Gilbert & Barker Mfg. Co.*, 160 Misc. 656, 290 N. Y. S. 462 (1936), accountant securing sales tax refunds; *Crawford v. McConnell*, 173 Okla. 520, 49 P. (2d) 551 (1935), tax protests and refund claims; *Blair v. Motor Carriers Service Bureau, Inc.*, 40 Pa. D. & C. 413 (1939), utility and

Argument in favor of eradicating the distinction between the lawyer's and the accountant's function in the tax field<sup>9</sup> has been based upon the fact that accountants are admitted to practice before the Treasury Department and the Tax Court. There is no valid foundation for this argument. The Treasury Department rules expressly prohibit accountants enrolled with it from practicing law,<sup>10</sup> and the Tax Court has permitted very few laymen to be admitted before it. Since January 1, 1943, non-lawyers have been admitted by it only upon examination. In one five-year period, ninety-two non-lawyers took the examination but only seven passed, of whom five were certified public accountants. Up until recently, not one of the seven has tried a case in the Tax Court,<sup>11</sup> and an analysis of the decisions thereof in the same five-year period shows that out of 3661 cases decided only 166, or 4.5%, were handled by non-lawyer certified public accountants who had been admitted prior to the examination requirement.<sup>12</sup> Statistics such as these speak for themselves.

It cannot be denied that tax laws and tax regulations today are so tightly bound up with interpretations of the courts that legal concepts necessarily become the basis upon which accountants outline the facts with which they must work. It is unavoidable that an accountant, when performing his accounting duties, must attempt to understand and follow the provisions of the law. In this process, he uses his knowledge of the law, perhaps even interprets it, for his own purposes in the performance of his accounting duties, but he does so merely as an incident to his primary hiring as an accountant. What he gets paid for, what he sells to the public, however, is not legal advice but an accounting product the legal sufficiency of which has not been tested and may never need be. The scope of accounting practice is well understood<sup>13</sup> and the province of the certified public accountant is well defined.<sup>14</sup> When an accountant in-

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interstate commerce consultants: *Walker v. Kahn*, 31 Pa. D. & C. 620 (1938), insurance agent executing bonds and applications for license. But see *State ex rel. Johnson v. Childe*, 147 Neb. 527, 23 N. W. (2d) 720 (1946), noted in 25 CHICAGO-KENT LAW REVIEW 238, appearance before state commerce commission.

<sup>9</sup> See *nisi prius* opinion in the instant case, 69 N. Y. S. (2d) 730 at 741, and also 78 N. Y. S. (2d) 209 at 218. Compare with discussions between groups of accountants and lawyers seeking to reach harmony on the point to be found in 63 Am. Bar Rep. 325, 69 Am. Bar Rep. 189, 263, 264, and 469, 70 Am. Bar Rep. 267, and 32 Am. Bar Ass'n Journ. 5. There is indication in 34 Am. Bar Ass'n Journ. 519 that the instant case was in the nature of a "test" proceeding.

<sup>10</sup> Treas. Dept. Circular 230, § 10.2(f).

<sup>11</sup> See statement of W. McNeil Kennedy referred to in note 4, ante.

<sup>12</sup> *Ibid.*, Exhibit One.

<sup>13</sup> An analysis thereof may be found in *Blair v. Motor Carriers Service Bureau, Inc.*, 40 Pa. D. & C. 413 at 431 (1939), and in *Bump v. District Court*, 232 Iowa 623, 5 N. W. (2d) 914 (1942).

<sup>14</sup> See definitions in Ill. Rev. Stats. 1947, Ch. 110½, § 7, and New York, State Education Law, Art. 57, § 1489(6). See also Am. Inst. of Accountants, Accounting Research Bulletin No. 9.

interprets the law for his own use in connection with these limited fields, time-honored forms and formulas will tend to be a check upon his interpretations. But interpretation of the law by accountants, apart from preparation of financial statements or when needed in the process of auditing books, falls clearly beyond the realm of accounting practice.

Insofar as the preparation of income tax returns is concerned, some courts have indicated that the preparation of anything but the simplest of returns amounts to practicing law.<sup>15</sup> The view expressed in the instant case is that the accountant should be allowed maximum freedom of action within the field of "tax accounting" to the end that a taxpayer be not required to go to a lawyer to have his tax return prepared.<sup>16</sup> Somewhere between these extremes, the line of demarcation will eventually be drawn.<sup>17</sup> In the meantime, when an accountant comes face to face with a difficult tax law problem in his legitimate practice, one which he recognizes requires interpretation hence calls for legal research and an analysis of court decisions, he should not hazard a guess at the solution but should guarantee to his client the best possible solution by recommending that he consult legal counsel.

With respect to drawing that line of demarcation, it should be remembered that a Pennsylvania court once said, "It is obvious that no wall can be built around the field of the law that will keep all lawyers within it and all laymen outside it."<sup>18</sup> Likening the situation to an old English case where a railroad's fence was defective and defendant's pigs strayed and did damage to a trolley car,<sup>19</sup> that court also quoted from the learned Baron Bramwell's remarks therein as follows: "Nor do we lay down that there must be a fence so close and strong that no pig could push through it, or so high that no horse or bullock could leap it. One could scarcely tell the limits of such a requirement, for the strength of swine is such that they would break through almost any fence, if there were a sufficient inducement on the other side. . . [It is] bound to put up such a fence that a pig not of a peculiarly wandering disposition, nor under any excessive temptation, will not get through it."<sup>20</sup> Putting it differently,

<sup>15</sup> *Merrick v. American Security & Trust Co.*, 107 F. (2d) 271, 71 App. D. C. 72, cert. den. 308 U. S. 625, 60 S. Ct. 380, 84 L. Ed. 521 (1940); *Lowell Bar Ass'n v. Loeb*, 315 Mass. 176, 52 N. E. (2d) 27 (1943). See also note in 42 Mich. L. Rev. 1122, and the issues of *Unauthorized Practice News*, particularly Vol. X, No. 2 and No. 4, and Vol. XII, No. 1.

<sup>16</sup> See 78 N. Y. S. (2d) 209 at 220.

<sup>17</sup> The amicable discussions between accountants and lawyers referred to in note 9, ante, should some day lead to an acceptable compromise.

<sup>18</sup> *Blair v. Motor Carriers Service Bureau, Inc.*, 40 Pa. D. & C. 413 at 421 (1939).

<sup>19</sup> The court referred to *Child v. Hearn*, 9 L. R. Ex. 176 (1874).

<sup>20</sup> 9 L. R. Ex. 176 at 181.

the doctrine of the instant case should be applied sensibly<sup>21</sup> to avoid any imputation that the legal profession seeks to establish a monopoly. Lawyers are not artisans joined into a trade union acting to serve only their own selfish ends. In fact, the term "monopoly" has no place in the vocabulary of the learned professions. It does not apply to those who are bound to their calling by a vow; it belongs in the jargon of the market-place. Lawyers are not, nay cannot be, in the market-place so the problem as to what shall constitute the practice of law is not to be solved by the competition of the market-place. Truly, in the public interest,<sup>22</sup> it is up to the courts to solve that problem. The instant case supplies a proper solution to at least one aspect thereof.

GRACE THOMAS STRIPLING

<sup>21</sup> It has been followed, with approval, by the highest court in New Jersey: *Auerbacher v. Wood*, — N. J. Eq. —, 59 A. (2d) 863 (1948), affirming 139 N. J. Eq. 599, 53 A. (2d) 800 (1947).

<sup>22</sup> In 28 Iowa L. Rev. 116, at 117, appears the statement: "No person of intelligence supposes that the organized medical profession makes war on quacks in order to get more business for reputable doctors. If that were its real purpose, the better professional strategy would be to let the quacks go ahead, since their practice would inevitably increase both the number of patients for legitimate physicians and the seriousness of their ailments. The same thought is true in the problem of the unauthorized practice of law. The reports are full of cases which never would have arisen had an attorney been employed at the start." The fight against unauthorized practice of law is, most often, conducted by unselfish and uncompensated groups acting solely in the public interest.

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## DISCUSSION OF RECENT DECISIONS

AUTOMOBILES—INJURIES FROM OPERATION, OR USE OF HIGHWAY—  
WHETHER OR NOT SERVICE OF PROCESS ON DESIGNATED STATUTORY AGENT  
CONFERS JURISDICTION OVER NON-RESIDENT DEFENDANT WHERE REGISTERED  
LETTER TO SUCH DEFENDANT CONTAINING NOTICE OF SUIT REMAINS UN-  
DELIVERED—In *Powell v. Knight*,<sup>1</sup> a case growing out of an automobile  
accident between a resident plaintiff and a non-resident defendant, the

<sup>1</sup> 74 F. Supp. 191 (1947).



plaintiff served process in the fashion directed by the local statute<sup>2</sup> by delivering a copy of the summons and the complaint to the designated statutory official who thereafter forwarded the same by registered mail to the last-known place of address of the defendant with a return receipt attached. The return receipt for the registered article was signed by defendant's mother-in-law, residing at the place of address, but the letter never reached the defendant because she had, in the meantime, moved to parts unknown and apparently never learned of the existence of the action against her. Despite this, an attorney appeared for the defendant, most likely acting to protect an insurance company who had issued a policy on the car, and he moved to abate the action for lack of service of process, basing such motion on the ground of failure to comply with the provision in question. That motion, at plaintiff's request, was overruled by the Federal District Court for the Eastern District of Virginia on the ground that plaintiff's efforts to procure service were sufficient, under the statute, to establish jurisdiction.

It is undoubtedly true that a court does not obtain *in personam* jurisdiction over a non-resident defendant unless there be service of process on him,<sup>3</sup> or on his agent, while within the territorial jurisdiction of the court. If that agent is one who has been personally appointed by the defendant, it can be presumed that knowledge of the pendency of the suit has been conveyed to the principal.<sup>4</sup> If, however, the agent is one not personally but only impliedly appointed by statute, some provision must be made in the statute for the giving of notice to the non-resident principal to meet the requirements of due process,<sup>5</sup> otherwise the attempted service will prove ineffective to satisfy jurisdictional requirements.<sup>6</sup> It is not necessary that actual notice, in fact, be given to the non-resident principal to sustain a service made upon his implied agent but, to meet constitutional requirements, the provision for notice must be such as to insure that he will, under ordinary circumstances, receive actual notice.

In the light of these requirements and in view of the prevalence of statutes designating some local official as agent for service for all non-

<sup>2</sup> Va. Code 1942, Tit. 18, Ch. 90B, § 2154(70) (i), directs: "... provided that notice of such service and a copy of the process or notice are forthwith sent by registered mail, with registered delivery receipt requested, by the director to the defendant ... and an affidavit of compliance herewith ... be filed with the declaration or notice of motion."

<sup>3</sup> *Pennoyer v. Neff*, 95 U. S. 714, 24 L. Ed. 565 (1878).

<sup>4</sup> The general presumption that knowledge on the part of the agent is to be deemed knowledge on the part of the principal should suffice for this purpose as well as for other purposes: *Curtis C. & H. Co. v. United States*, 262 U. S. 216, 43 S. Ct. 570, 67 L. Ed. 954 (1923).

<sup>5</sup> *Hess v. Pawlowski*, 274 U. S. 352, 47 S. Ct. 632, 71 L. Ed. 1091 (1927).

<sup>6</sup> *Wuchter v. Pizzutti*, 276 U. S. 13, 48 S. Ct. 259, 72 L. Ed. 446, 57 A. L. R. 1230 (1928).

resident drivers who use the highways of other states, at least as to causes of action growing out of such use of those highways, there is occasion to review the several provisions currently in force. One group of statutes, found in twenty-seven states and the District of Columbia,<sup>7</sup> may be exemplified by the language found in the New York act which directs that "notice of such service and a copy of the summons and complaint are to be forthwith sent by registered mail by the plaintiff to the defendant. The defendant's return receipt, the plaintiff's affidavit of compliance and a copy of the summons and complaint shall be filed with the clerk of the court in which the action is pending."<sup>8</sup> By requiring the filing of record of a return receipt signed by the defendant, these jurisdictions have gone to the extreme to insure notice short of requiring proof that the non-resident defendant has opened the registered article and examined the contents. Nothing less will suffice, for those courts which have had occasion to pass upon the meaning of such a provision have interpreted it to require that the defendant actually receive the notice of the pendency of the suit.<sup>9</sup>

A second group of statutes, effective in thirteen states,<sup>10</sup> may be typified by the Illinois provision which directs that "notice of such service

<sup>7</sup> D. of C. Code 1940, Tit. 40, Ch. 4, § 40-403; Ala. Code 1940, Tit. 7, § 199; Ariz. Code Ann. 1939, Ch. 66, § 227; Cal. Deering Vehicle Code Ann. 1944, Ch. 1, § 404; Colo. Stats. Ann. 1935, Vol. 2, Ch. 16, § 48(1); Del. Laws, Vol. 35, Ch. 225, § 2; Fla. Stats. 1941, Tit. 6, Ch. 47, §§ 47.29-47.30; Ga. Laws 1937, Part 1, Tit. 6, No. 444, at p. 732; Ida. Code Ann. 1932 (1940 Supp.), Tit. 48, Ch. 5a, § 32; Burns' Ind. Stats. Ann. 1933, Vol. 8, Ch. 10, § 47-1043; Iowa Code 1946, Vol. 1, Ch. 321, § 321.501; La. Dart Civ. Code 1939, Vol. 4, Ch. 4, § 5297; Me. Rev. Stat. 1944, Vol. 1, Ch. 19, § 59; Flack Ann. Md. Code 1939, Vol. 2, Art. 56, § 167; Mass. Laws 1933, Vol. 3, Ch. 90, § 3c; Mich. Stats. Ann. 1937, Vol. 8, Tit. 9, Ch. 74, § 9.1701; Miss. Laws 1938, Ch. 148, § 11; Mont. Rev. Code 1935, Vol. 1, Ch. 152, § 1760.14; Nev. Comp. Laws (1931-41 Supp.), Vol. 1, § 4441.01; N. J. Stat. Ann., Tit. 2, Ch. 32, § 2:32-34.2; Cahill Cons. Laws N. Y., 1937 Supp., Ch. 64-a, § 52; N. Car. Gen. Stats. 1943, Vol. 1, Ch. 1, § 1-105; Okla. Stats. Ann. (Perm. Ed.), Tit. 47, Ch. 1, § 7; Ore. Comp. Laws Ann. 1940, Vol. 8, Tit. 115, Art. 5, § 115-129; S. Car. Code 1942, Vol. 1, Tit. 7, Ch. 16, § 437; Williams' Tenn. Code Ann. 1934, Vol. 6, Tit. 1, Ch. 5, Art. 4, §§ 8671, 8672 and 8673; Remington's Wash. Rev. Stat. Ann. 1937, Vol. 7a, Tit. 41, § 6360-129; W. Va. Code Ann. 1943, Ch. 56, § 5555(1).

<sup>8</sup> Cahill Cons. Laws N. Y., 1937 Supp., Ch. 64-a, § 52. The statutes cited in note 7, ante, are not identical in language but all possess similar purport to the New York provision.

<sup>9</sup> Smyrnios v. Weintraub, 3 F. Supp. 439 (1933); Syracuse Trust Co. v. Keller, 5 W. W. Harr. (35 Del.) 304, 165 A. 327 (1932); Spearman v. Stover, 184 La. 620, 170 So. 259 (1936). In New York, the court has gone so far as to say that if the defendant refuses to accept the registered letter, the plaintiff has not complied with the statute: Dwyer v. Shalck, 232 App. Div. 780, 248 N. Y. S. 355 (1931). But see contra: Creadick v. Keller, 5 W. W. Harr. (35 Del.) 169, 160 A. 909 (1932); State ex rel. Charette v. Dist. Ct. of Second Judicial District, 107 Mont. 489, 86 P. (2d) 750 (1939); and Mull v. Taylor, 68 Ga. App. 663, 23 S. E. (2d) 595 (1942), where it was held that, compliance with the statute having been rendered impossible by the defendant's own wilful conduct, he was in no position to complain.

<sup>10</sup> Ark. Pope Dig. 1937, Vol. 1, Ch. 22, § 1375; Conn. Gen. Stats. 1930, Tit. 58, Ch. 288, § 5473; Ill. Rev. Stat. 1947, Ch. 95½, § 23; Minn. Stats. Ann. 1945, Vol. 12, Ch. 170, § 170.55; Mo. Rev. Stat. Ann. 1939, Vol. 18, Ch. 45, Art. 1, § 8410.5; Neb.

and a copy of the process are . . . to be sent by registered mail by the plaintiff to the defendant, at the last known address of the said defendant, and the plaintiff's affidavit of compliance herewith is to be appended to the summons."<sup>11</sup> Since these provisions merely direct that the notice be sent to the "last known address" of the defendant, there is indication of a legislative intent that actual delivery to the non-resident shall not be deemed a prerequisite to jurisdiction.<sup>12</sup> That result, at least, was achieved in the Ohio case of *Hendershot v. Ferkel*<sup>13</sup> although the statute there also provides that the return receipt of the defendant should be filed in the record. But strict construction must be given to the words "last known address" in order to comply with fundamental constitutional concepts of due process<sup>14</sup> as well as to prevent fraud in the obtaining of a judgment by default. As the Connecticut court observed in the case of *Hartley v. Vitiello*,<sup>15</sup> unless the defendant has departed for parts unknown, that phrase means his "actual address. If he has disappeared, it means his last address so far as it is reasonably possible to ascertain it. This address the plaintiff must learn at his own peril, and only if the copy is mailed to it is there a compliance with the statute."<sup>16</sup>

Four other statutes, comprising the third group which includes the one involved in the instant case,<sup>17</sup> are susceptible of two interpretations, i.e. that actual delivery of notice is or is not required to effectuate process. These statutes do not require that notice be sent to the "last known address" of the defendant nor impose the requirement that the return receipt be filed in the action. Those found in Kansas, Texas and Vermont merely provide that the registered mail be sent "to the defendant," although the Virginia one adds the further proviso that a registered delivery receipt be "requested." It would be possible, by giving a literal

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Rev. Stat. 1943, Vol. 2, Ch. 25, Art. 5, § 25-530; N. Dak. Rev. Code 1943, Vol. 3, Ch. 28-06, § 28-0612; Page's Ohio Gen. Code Ann., Vol. 4a, Ch. 21, § 6308-2; Purdon's Pa. Stats. Ann., Tit. 75, Ch. 4, § 1202; S. Dak. Code 1939, Vol. 2, Ch. 33.08, § 33.0809; Utah Code Ann. 1943, Vol. 3, Tit. 57, Ch. 13, § 12; Wis. Stats. 1945, Ch. 85, § 85.05(3); Wyo. Comp. Stat. Ann. 1945, Vol. 4, Ch. 60, § 60-1101.

<sup>11</sup> Ill. Rev. Stat. 1947, Ch. 95½, § 23.

<sup>12</sup> *Hartley v. Vitiello*, 113 Conn. 74, 154 A. 255 (1931); *Schilling v. Odlebak*, 224 N. W. 694, 177 Minn. 90 (1929), approving *Jones v. Paxton*, 27 F. (2d) 364 (1928); *Herzoff v. Hommell*, 120 Neb. 475, 233 N. W. 458 (1930); *Ashbrook v. Otto*, 2 Ohio O. 534 (1935); *Wax v. Van Marter*, 124 Pa. Super. 573, 189 A. 537 (1937); *Sorenson v. Stowers*, 251 Wis. 398, 29 N. W. (2d) 512 (1947); *State ex rel. Cronkhite v. Beldon*, 193 Wis. 145, 211 N. W. 916, 57 A. L. R. 1218 (1927).

<sup>13</sup> 144 Ohio St. 112, 56 N. E. (2d) 205 (1944).

<sup>14</sup> *Wuchter v. Pizzutti*, 276 U. S. 13, 48 S. Ct. 259, 72 L. Ed. 446, 57 A. L. R. 1230 (1928).

<sup>15</sup> 113 Conn. 74, 154 A. 255 (1931).

<sup>16</sup> 113 Conn. 74 at 80, 154 A. 255 at 258.

<sup>17</sup> Kan. Gen. Stats. 1935, Ch. 8, Art. 4, § 8-402; Vernon's Tex. Civ. Stat. Ann., Vol. 5, Tit. 42, Art. 2039a; Vt. Pub. Laws 1933, Tit. 22, Ch. 208, § 5002; Va. Code, Tit. 18, Ch. 90B, § 2154(70) (i).

interpretation to the phrase "to the defendant," to reach the result that actual delivery would be necessary,<sup>18</sup> but in view of the tenor of the language used by the United States Supreme Court in the case of *Wuchter v. Pizzutti*<sup>19</sup> it would seem to be more in keeping with the policy underlying these statutes not so much to require actual delivery of notice to the non-resident as to expect that the plaintiff will make an honest effort to effectuate that delivery.<sup>20</sup>

If that is the policy, the burden should be placed upon the defendant to apprise himself of the fact that a suit has been brought against him rather than to deprive the plaintiff of his remedy because his honest efforts have failed to accomplish the fact of notice. The court in the instant case, at least, adopted this view and there is much to justify such a holding.

J. A. SACCONI

CHARITIES—CONSTRUCTION, ADMINISTRATION, AND ENFORCEMENT—WHETHER OR NOT CHARITABLE CORPORATION WHICH HAS INSURED AGAINST TORT LIABILITY FOR NEGLIGENCE MAY INVOKE DEFENSE OF IMMUNITY—The Appellate Court for the First District recently considered and decided the case of *Wendt v. Servite Fathers*,<sup>1</sup> an ordinary negligence action brought in behalf of a minor plaintiff to recover damages for injuries sustained by him when playing in a stadium owned by defendant. The defendant pleaded that it was an eleemosynary institution by reason whereof plaintiff was not entitled to any damages against it for his injuries. The reply filed by plaintiff alleged that the defendant carried a liability insurance policy by the terms of which the insurance carrier had agreed to pay on behalf of the defendant all sums which the defendant should become obligated to pay for damages because of injuries sustained by any person while on defendant's premises. After separate hearings before

<sup>18</sup> *Syracuse Trust Co. v. Keller*, 5 W. W. Harr. (35 Del.) 304, 165 A. 327 (1932).

<sup>19</sup> 276 U. S. 13, 48 S. Ct. 259, 72 L. Ed. 446, 57 A. L. R. 1230 (1928).

<sup>20</sup> Four other statutes are not capable of classification. N. H. Rev. Laws 1942, Vol. 1, Ch. 116, § 43, requires filing of the return receipt but, against the possibility that the registered article cannot be delivered, permits the court to order such additional service "as justice may require." Ky. Rev. Stat. 1946, Ch. 188, § 188.030, likewise provides for filing of a return receipt but it was interpreted, in *Morris v. Argo-Collier Truck Lines*, 39 F. Supp. 602 (1941), so as not to require delivery to defendant. The New Mexico provision, N. M. Stats. Ann. 1941, Vol. 5, Ch. 68, Art. 10, § 68-1004, does not authorize service by registered mail at all but calls for delivery "to the defendant personally without the state," together with proof of such service by affidavit, in much the same fashion as is permitted in Illinois in order to confer in rem but not in personam jurisdiction: Ill. Rev. Stat. 1947, Ch. 110, § 140. The Rhode Island provision R. I. Gen. Laws 1938, Ch. 103, § 1, requires the filing of the "sender's postoffice receipt of sending" in the action, but says nothing about requesting a return receipt or the filing thereof.

<sup>1</sup> 332 Ill. App. 618, 76 N. E. (2d) 342 (1947).

two judges in the trial court, the case terminated in a judgment dismissing plaintiff's complaint.<sup>2</sup> On plaintiff's appeal, the judgment dismissing the complaint was reversed and the cause was remanded on the ground that "where insurance exists and provides a fund from which tort liability may be collected so as not to impair the trust fund, the defense of immunity is not available."<sup>3</sup>

The law in the United States on the subject of the tort liability of charitable corporations is lacking in uniformity, both as to reasons and results. Immunity was originally granted an eleemosynary corporation<sup>4</sup> in the first case<sup>5</sup> in this country, which arose in Massachusetts, on the basis of an English precedent<sup>6</sup> which had been overruled<sup>7</sup> before that decision was achieved. The Massachusetts case was, nevertheless, followed in the early cases, except in Rhode Island.<sup>8</sup> After the adoption of this non-liability rule, whether on the "trust fund," "waiver," or public policy theories, the courts of this country attempted to skirt its effect, some by rejecting the rule outright,<sup>9</sup> while others laboriously achieved liability despite the rule.<sup>10</sup> As a result, numerous exceptions were developed.<sup>11</sup> It was with the suspected intention of directing attention to and, perhaps, unifying this chaotic field of law that so meritorious an effort was made, in the case of *President and Directors of Georgetown College v. Hughes*,<sup>12</sup> to reconsider the arguments theretofore used in support of immunity granted to charitable institutions.

<sup>2</sup> The case was heard first by Fisher, J., who, by his ruling striking out the defense that defendant was an eleemosynary institution and allowing plaintiff's allegations as to insurance to stand, plainly held that the defendant could be liable in damages. At the trial, Anderson, J., refused to accept any evidence offered by plaintiff and, with the record showing the prior ruling, entered an order dismissing the suit.

<sup>3</sup> 332 Ill. App. 618 at 634, 76 N. E. (2d) 342 at 349.

<sup>4</sup> Immunity from tort liability has never been granted to individual volunteers: *Cavey v. Davis*, 190 Iowa 720, 180 N. W. 889, 12 A. L. R. 904 (1921), *Depue v. Flatau*, 100 Minn. 299, 111 N. W. 1, 8 L. R. A. (N. S.) 485 (1907).

<sup>5</sup> *McDonald v. Massachusetts General Hospital*, 120 Mass. 432, 21 Am. Rep. 529 (1876).

<sup>6</sup> *Holliday v. St. Leonard*, 11 C. B. (N. S.) 192 (1861).

<sup>7</sup> *Foreman v. Mayor of Canterbury*, L. R. 6 Q. B. 214 (1871).

<sup>8</sup> *Galvin v. Rhode Island Hospital*, 12 R. I. 411, 34 Am. Rep. 675 (1879). The court, in passing, said that as the legislature created the corporation it ought to grant the immunity too. It is understood that, following the suggestion thus made, the Rhode Island legislature subsequently enacted a statute making charitable corporations free from tort liability.

<sup>9</sup> *Mulliner v. Evangelischer Diakonniessenverein*, 144 Minn. 392, 175 N. W. 699 (1920); *Hewett v. Woman's Hospital Aid Ass'n*, 73 N. H. 556, 64 A. 190, 7 L. R. A. (N. S.) 496 (1906).

<sup>10</sup> See, for example, *Sheehan v. North Country Community Hospital*, 273 N. Y. 163, 7 N. E. (2d) 28, 109 A. L. R. 1197 (1937). See also McCaskill, "Respondent Superior as Applied in New York to Quasi-Public and Eleemosynary Corporations," 5 Corn. L. Q. 409, 6 Corn. L. Q. 56 (1920).

<sup>11</sup> A breakdown of the cases and their varied holdings appears in the case of *President and Dir. of Georgetown College v. Hughes*, 130 F. (2d) 810 at 818-22 (1942).

<sup>12</sup> 130 F. (2d) 810 (1942).

Illinois courts were first called upon to determine the liability of charitable corporations in 1905, at which time it was decided that the funds and property of such organizations were held in trust and could not be diverted for the purpose of paying damages in satisfaction of injuries caused by the negligent acts of their employees to persons who were enjoying the benefits of the charity.<sup>13</sup> It was not until 1942, in the case of *Myers v. Young Men's Christian Association of Quincy*,<sup>14</sup> that the problem of the effect of insurance upon the immunity of an eleemosynary institution came before an Illinois reviewing court. There the count alleging coverage by an insurance company was stricken for the reason that it would call to the attention of the jury the fact that the defendant was protected by insurance, a point not permitted even in the case of non-charitable defendants.<sup>15</sup> The course of the pleadings in the instant case, however, avoided that possibility for no mention was made of insurance until it became necessary for the plaintiff to file a reply and, even then, no debatable issue arose for the defendant did not deny the existence of insurance. Furthermore, the plaintiff skillfully avoided any imputation that trust funds might be jeopardized by voluntarily waiving any right to levy upon the property of the corporate defendant and by keeping the demand for judgment within the policy limits.

Only one other Illinois case has involved the same problem, that of *Piper v. Epstein*,<sup>16</sup> but the court in the instant case felt that it was not bound, under the doctrine of *stare decisis*,<sup>17</sup> to follow the holding therein. The court there did not decide the issue of liability as it might be affected by insurance but rather interpreted the holding in *Parks v. Northwestern University*<sup>18</sup> as establishing a rule of absolute immunity which, the court said, "has been followed in an unbroken line of decisions."<sup>19</sup> In the forty-odd years between the determination in the Parks case and that in the Piper case, there were fourteen citations of the initial decision in this state, six in the Supreme Court and eight in the various Appellate Courts. One has no bearing at all on the present question for it was a tax case.<sup>20</sup>

<sup>13</sup> *Parks v. Northwestern University*, 218 Ill. 381, 75 N. E. 991, 2 L. R. A. (N. S.) 556, 4 Ann. Cas. 103 (1905).

<sup>14</sup> 316 Ill. App. 177, 44 N. E. (2d) 755 (1942), noted in 21 CHICAGO-KENT LAW REVIEW 256, 10 U. of Chi. L. Rev. 211.

<sup>15</sup> A related problem, that of disclosing the fact of insurance in the course of interrogating prospective jurors, is discussed in *Wheeler v. Rudek*, 397 Ill. 438, 74 N. E. (2d) 601 (1947). See also *Smithers v. Henriquez*, 368 Ill. 588, 15 N. E. (2d) 499 (1938).

<sup>16</sup> 326 Ill. App. 400, 62 N. E. (2d) 139 (1945). See criticism thereof in 24 CHICAGO-KENT LAW REVIEW 266.

<sup>17</sup> A solitary decision of recent date never is held to irrevocably state the law: *Hopkins v. McCann*, 19 Ill. 112 (1857), *Frink v. Darst*, 14 Ill. 304 (1853).

<sup>18</sup> 218 Ill. 381, 75 N. E. 991, 2 L. R. A. (N. S.) 556, 4 Ann. Cas. 103 (1905).

<sup>19</sup> *Piper v. Epstein*, 326 Ill. App. 400 at 406, 62 N. E. (2d) 139 at 143.

<sup>20</sup> *People v. Ravenswood Hospital*, 238 Ill. 137, 87 N. E. 305 (1909).

Three consider whether or not the receiving of paying strangers rather than true recipients of charity operates to change the character of the charitable corporation,<sup>21</sup> while a fourth flatly holds that the stranger who has paid for the services cannot recover.<sup>22</sup> The sixth case permitted recovery when the suit was based on breach of contract,<sup>23</sup> but the seventh repudiated that holding, saying that the nature of the action should have no bearing on the question of tort liability.<sup>24</sup> Three more cases restate the trust fund doctrine as originally set forth<sup>25</sup> and, of the remainder, four state the general proposition that charitable corporations are not liable under the doctrine of *respondeat superior* without mentioning the theoretical basis, being content merely to cite the Parks case.<sup>26</sup> Only in *Klopp v. Benevolent Protective Order of Elks*,<sup>27</sup> which did not cite the Parks decision, was it held that a benevolent organization which maintained a licensed bar and put the profits therefrom into the treasury could be subjected to liability under the Dram Shop Act.<sup>28</sup>

From these cases it would appear that while the Illinois courts have held that the doctrine of *respondeat superior* should not extend to charitable institutions because the trust funds thereof might be destroyed or diverted, yet in no case, except that of *Piper v. Epstein*,<sup>29</sup> has it been held that the exemption from liability is absolute. It would rather seem that non-liability is to be the rule only when a contrary decision would serve to deplete the trust fund. If that is so, it would follow that the rule of non-liability should be cast aside when the charitable organization does carry insurance, whether that insurance be indemnity or liability protection. Other jurisdictions may have refused recovery when the insurance was of the indemnity type,<sup>30</sup> but there is no distinction made

<sup>21</sup> *Morgan v. National Trust Bank*, 331 Ill. 182, 162 N. E. 888 (1928); *Summers v. Chicago Title & Trust Co.*, 335 Ill. 564, 167 N. E. 777 (1929); *Tollefson v. City of Ottawa*, 129 Ill. App. 139 (1906).

<sup>22</sup> *Hogan v. Chicago Lying-In Hospital*, 247 Ill. App. 331 (1928). That case might involve a misinterpretation of the decision in the Parks case, for it was there said that trust funds should not be diverted to pay damages for injuries due to the negligent or wrongful acts of servants to "persons who are enjoying the benefit of the charity."

<sup>23</sup> *Armstrong v. Wesley Hospital*, 170 Ill. App. 81 (1912).

<sup>24</sup> *Wattman v. St. Luke's Hospital Ass'n*, 314 Ill. App. 244, 41 N. E. (2d) 314 (1942).

<sup>25</sup> *Hogan v. Chicago Lying-In Hospital*, 355 Ill. 42, 166 N. E. 461 (1929); *Marabia v. Mary Thompson Hospital*, 224 Ill. App. 367 (1922); *Alton Mfg. Co. v. Garrett Biblical Inst.*, 148 Ill. App. 23 (1909).

<sup>26</sup> *Hendricks v. Urbana Park Dist.*, 265 Ill. App. 102 (1932); *Curtis v. City of Paris*, 234 Ill. App. 157 (1924); *Johnston v. City of Chicago*, 258 Ill. 494, 101 N. E. 960 (1913); *Tollefson v. City of Ottawa*, 228 Ill. 134, 81 N. E. 823 (1907).

<sup>27</sup> 309 Ill. App. 145, 33 N. E. (2d) 161 (1941).

<sup>28</sup> Ill. Rev. Stat. 1947, Ch. 43, § 135.

<sup>29</sup> 326 Ill. App. 400, 62 N. E. (2d) 139 (1945).

<sup>30</sup> *Williams v. Church Home*, 223 Ky. 355, 3 S. W. (2d) 753, 62 A. L. R. 721 (1928); *Mississippi Baptist Hospital v. Moore*, 156 Miss. 676, 126 So. 465, 67 A. L. R. 1106 (1930).

in Illinois<sup>31</sup> and none should be for in either event the charitable corporation is needlessly paying out trust funds to purchase insurance to protect it from a liability which does not exist if the courts fail to recognize liability where there is insurance. The whole trust fund argument itself is based on the concept that the donor would not give if he thought his funds would be diverted to the purpose of satisfying judgments.<sup>32</sup> Is it reasonable to suppose that he would donate if he thought the income from such funds would be used to pay premiums to an insurance company organized for profit to protect his favorite charity from a non-existent liability? Other jurisdictions have felt that the presence of insurance is enough to protect the trust funds so donated and they have, accordingly, denied immunity.<sup>33</sup> There is no legal objection to a similar holding here.

One other point deserves notice. The insurance policy in the instant case contained a rider providing that the carrier would not use the immunity of the insured in the defense of its suits unless requested so to do by the insured.<sup>34</sup> There is occasion to believe that this provision constitutes a highly unconscionable agreement between insured and insurer, for the existence of public liability insurance has come to mean a matter of benefit to the public as well as to the insured.<sup>35</sup> Once an accident has occurred in the ordinary case, the liability of the insurance company is fixed. No act or agreement on the part of the insured will allow the insurance company to escape the liability assumed by it under the insurance policy, for it has been said that the "rights of the injured party arise immediately upon the happening of the accident. This right, arising from contract, cannot be destroyed by an attempted subsequent cancellation, release, or compromise by the insured and the insurer."<sup>36</sup>

<sup>31</sup> Ill. Rev. Stat. 1947, Ch. 73, § 1000, now gives the injured person a right to maintain an action against the insurance company. The problem of insurance, and of indemnity in particular, was treated in an unpublished opinion in the case of *Shaleem v. The Newberry Library*, 39-S-11479, Superior Court of Cook County, Illinois. Fankhauser, J., there noted that "If you eliminate from this opinion the court's concern [i.e. the concern expressed in *Parks v. Northwestern University*] for the protection of the fund, what would be left upon which to base the opinion? . . . When the fund is not jeopardized and cannot be reached to satisfy a judgment against the institute, the question of non-liability manifestly disappears." See also *Vanderbilt University v. Henderson*, 23 Tenn. App. 135, 127 S. W. (2d) 284 (1938), where the judgment was expressly made payable out of the proceeds of the liability insurance.

<sup>32</sup> See the discussion of this point in *Parks v. Northwestern University*, 218 Ill. 381 at 385, 75 N. E. 991 at 993 (1905).

<sup>33</sup> *O'Connor v. Boulder Colorado Sanitarium Ass'n*, 105 Colo. 259, 96 P. (2d) 835, 133 A. L. R. 819 (1939); *Taylor v. Knox County Board of Education*, 292 Ky. 767, 167 S. W. (2d) 700 (1943); *Vanderbilt University v. Henderson*, 23 Tenn. App. 135, 127 S. W. (2d) 284 (1938).

<sup>34</sup> 332 Ill. App. 618 at 620, 76 N. E. (2d) 342 at 343.

<sup>35</sup> Ill. Rev. Stat. 1947, Ch. 95½, § 58b, is indicative of a legislative trend to insist upon insurance for the benefit of third persons.

<sup>36</sup> *Spann v. Commercial Standard Ins. Co. of Dallas, Texas*, 82 F. (2d) 593 at 599 (1936), quoted with approval in *Scott v. Freeport Casualty Co.*, 392 Ill. 332, 64 N. E. (2d) 542 (1946).



Clearly, if this were not the rule, the insured could grant or withhold assured compensation for its negligent acts as it pleased. If the insured may not do so after injury, there is reason to believe it should not be allowed to do so beforehand. No individual or corporate body should be allowed such discriminatory power, much less so if it enjoys the privileges accorded to charitable corporations. To the extent that they see fit to carry insurance, they should provide protection without stint.

The holding in the instant case recognizes a modern trend which has been argued for by legal scholars and jurists alike. But it presents only the first step forward. The general immunity granted to charitable corporations by the courts should be withdrawn. The legislature has not seen fit to act and it is not necessary that it should for it was not the legislature that granted this immunity, even though it has seen fit to grant other privileges. The change can, and should, be brought about by the courts.

MISS C. L. SAMUELSON

DEATH—ACTIONS FOR CAUSING DEATH—WHETHER OR NOT FRAUD OF DEFENDANT IN MISREPRESENTING FACTS BEARING ON PERSONALITY OF PROPER DEFENDANT PREVENTS TIME PROVISIONS OF WRONGFUL DEATH STATUTE FROM OPERATING TO BAR SUIT FOR WRONGFUL DEATH—The recent Ohio case of *Sabol v. Pekoc*<sup>1</sup> required that interpretation be placed upon a time provision contained in a statute creating a cause of action for wrongful death.<sup>2</sup> In that case, the facts disclosed that plaintiff's intestate had been employed as a janitress by the defendant in the latter's building. In the course of that employment, the decedent met her death through the negligence of the defendant. Upon hearing of this misfortune, the defendant informed the plaintiff that his, the defendant's, mother was the owner of the building and he recommended that suit be brought against her as she was adequately insured. A suit was, accordingly, promptly brought against the mother. The plaintiff subsequently discovered that the present defendant, the son, was the actual owner of the building and responsible for the death so another action was instituted against him. To that action the defendant filed a demurrer, relying on the ground that the action was not brought within the time fixed by the Ohio statute,<sup>3</sup> hence the complaint did not state a cause of action. The trial court sustained the demurrer but, on appeal, the Court of Appeals of Ohio reversed, holding that the active fraud practiced by the defendant

<sup>1</sup> 148 Ohio St. 545, 76 N. E. (2d) 84 (1947).

<sup>2</sup> Ohio Gen. Code 1947, §§ 10509-166 to 10509-169.

<sup>3</sup> Ibid., § 10509-167, provides: "... every such action must be commenced within two years after such death of such deceased person. . . ."

was the cause of the failure to sue more promptly.<sup>4</sup> It concluded that the time for bringing the action did not begin to run until the fraud was discovered and that the defendant was, by his own conduct, estopped from asserting such a defense.<sup>5</sup> On further appeal, the Ohio Supreme Court reversed on the ground that general principles of law which might serve to toll the time for bringing an ordinary action were not applicable to actions such as the one in question and, in the absence of a special saving clause, the suit was barred.

The wrongful death of a human being, at common law, did not give rise to any civil cause of action whatever<sup>6</sup> but, to ameliorate the harshness of such a rule, the English Parliament, in 1846, passed the celebrated Lord Campbell's Act<sup>7</sup> which has served as the model for similar acts in this country. All such statutes contain within themselves a time provision dealing with the period within which the action must be brought,<sup>8</sup> and such time stipulations have been the cause of much litigation and comment. The problem created thereby resolves itself into one as to whether such time period should be treated pre-emptively, *i.e.* as affecting the right, or whether it should be treated prescriptively, thereby affecting the remedy only. If the former, common law or other statutory reasons for tolling the period would not apply; if the latter, they would.

The Ohio court in the instant case reasoned that, since the statute providing for an action for death was in derogation of the common law, a petition to recover thereon must be filed strictly according to the statute's essential terms, for such was the sole source of the right upon which the petition was based.<sup>9</sup> If, therefore, such a statute requires that the action should be commenced within a specified time after the death, the provision is to be treated as a condition qualifying the right of action, and not a mere limitation on the remedy. In other words, the time limitation is not properly a period of limitation, as that term is generally understood, but serves rather as a qualification and condition restricting the right granted.

<sup>4</sup> — Ohio App. —, 72 N. E. (2d) 270 (1947).

<sup>5</sup> The court apparently relied on the general rule that one may not take advantage of his own wrongdoing and seek refuge under the statute of limitations when he has, by fraudulent conduct or representations, successfully concealed his liability beyond the period fixed by law: *Neff v. New York Life Ins. Co.*, 30 Cal. (2d) 165, 180 P. (2d) 900 (1947); *Fortune v. English*, 226 Ill. 262, 80 N. E. 781 (1907). See also Ill. Rev. Stat. 1947, Ch. 83, § 23.

<sup>6</sup> *Baker v. Bolton*, 1 Camp. 493, 170 Eng. Rep. 1033 (1808). See also 25 C. J. S., Death, § 13, p. 1072.

<sup>7</sup> 9 and 10 Vict., c. 93 (1846).

<sup>8</sup> See, for example, Ill. Rev. Stat. 1947, Ch. 70, § 2.

<sup>9</sup> Under a comparable provision in the Federal Employers Liability Act, the court in *American Ry. Co. of Puerto Rico v. Coranas*, 230 F. 545 at 546 (1916), pointed out that the bringing of the action within the specified time is a "condition to the exercise of the right, and if the condition is not complied with, the parties stand with respect to the wrongful act as though the statute had not been enacted."

Not being a true statute of limitation, common law or other statutory rules which would permit avoidance of a defense of the statute of limitations would be inapplicable to a plea that the wrongful death action was not commenced within the time prescribed. Such has likewise been the holding of all the courts which have had occasion to decide the issue with but a single exception.<sup>10</sup> That holding has been achieved not only where the facts on the face of the complaint provide clear evidence that the action was brought too late<sup>11</sup> but also where other grounds for tolling an ordinary statute of limitations such as concealment of a cause of action,<sup>12</sup> absence from the jurisdiction,<sup>13</sup> legal disability,<sup>14</sup> and inadvertent failure of the prior action,<sup>15</sup> have been made to appear.

Although the courts of Illinois have never decided this exact issue, the path pursued on a similar question has been a curious one. In *Lake Shore & Michigan Southern Railway Company v. Dylanski*,<sup>16</sup> the problem was whether or not one aspect of the saving clauses in the Limitation Act<sup>17</sup> could operate in a case arising under the Injuries Act,<sup>18</sup> and particularly whether or not an involuntary nonsuit of an action promptly brought thereunder could serve to save another wrongful death action begun after the prescribed period but well within the time fixed by the saving statute mentioned. The Illinois Appellate Court refused to extend the time period fixed by the Injuries Act, despite the nonsuit of the original action, hence held the second action was barred. That view was again reiterated in *Wall v. Chesapeake & Ohio Railway Company*,<sup>19</sup> where the court stated that the bringing of an action for wrongful death within the time fixed by the Injuries Act was a condition precedent to recovery, consequently a declaration which did not, on its face, show that the action was brought within such period was subject to demurrer. On appeal to the Illinois Supreme Court, however, that decision was reversed and it was indicated that the time period might or might not be a condition precedent to

<sup>10</sup> See cases cited in annotations in 67 A. L. R. 1059 and 132 A. L. R. 322. But see *Brookshire v. Burkhardt*, 141 Okla. 1, 283 P. 571 (1930). The defendants there concealed that they were responsible for the bombing that caused the death of the plaintiff's intestate. The upper court, reversing an order which had sustained a demurrer to the complaint, stated that the time provision in the Oklahoma statute was merely a statute of limitation because the section giving the right to sue was in the same chapter of the code as the one dealing with limitations in general, hence bore evidence of a legislative intent that the time limit should be treated as an ordinary statute of limitation.

<sup>11</sup> *The Harrisburg*, 119 U. S. 199, 7 S. Ct. 140, 30 L. Ed. 358 (1886).

<sup>12</sup> *Bell v. Wabash Ry. Co.*, 58 F. (2d) 569 (1932).

<sup>13</sup> *Taylor v. Southern Ry. Co.*, 6 F. Supp. 259 (1934).

<sup>14</sup> *Westcott v. Young*, 275 Mass. 82, 175 N. E. 153 (1931).

<sup>15</sup> *Partee v. St. Louis Ry. Co.*, 204 F. 970 (1913).

<sup>16</sup> 67 Ill. App. 114 (1896).

<sup>17</sup> Ill. Rev. Stat. 1947, Ch. 83, § 23.

<sup>18</sup> *Ibid.*, Ch. 70, § 2.

<sup>19</sup> 101 Ill. App. 431 (1902).

plaintiff's right to recover for each case had to depend on its own particular facts, so the plaintiff should be given an opportunity to set up any facts which might form an exception to the statute of limitations.<sup>20</sup> That line of reasoning was followed in two subsequent cases.<sup>21</sup>

Within five years thereafter the Illinois Appellate Court, in *Rabig v. Cleveland, Cincinnati, Chicago & St. Louis Railroad Company*,<sup>22</sup> went back to and reaffirmed the views expressed in the Dylanski case and refused to permit application of the saving clause concerning new actions begun after nonsuit to suits based on the Injuries Act. Since that time, the decisions in this state have been uniform on the point that the time provision in the Injuries Act serves as a condition precedent to the right of action.<sup>23</sup>

By so returning to the view followed by an almost unanimous majority of courts elsewhere, the Illinois courts again gave logical application to the fundamental premise that time limits in statutory actions such as the one for wrongful death are to be treated pre-emptively. Reason demands the conclusion attained under the majority rule for statutes of that character are creative in nature and fix the necessary elements which the plaintiff must allege and prove in order to qualify for the right there provided. As prompt action is one of these elements, the plaintiff should necessarily allege and prove compliance as a condition to the enjoyment of the right rather than to expect the defendant to counter with a claim that long delay should serve as a limitation on the remedy.

Yet it seems difficult to reconcile such logical reasoning with the fact that the very purpose of wrongful death statutes was to relieve against harsh results produced by the common law. No one could deny that the result reached in the instant case, although logically correct, is gravely unjust and apt to encourage fraud as a means to avoid liability. That sort of injustice and deception has been prevented, as to ordinary suits, by the adoption of general savings provisions. If they are not available for use in wrongful death or similar statutory actions, it would seem high time that they were made applicable through suitable statutory modification in, or addition to, the statute which serves to create the right.

S. A. MALATO

<sup>20</sup> 200 Ill. 66, 65 N. E. 632 (1902). Subsequent thereto, the case had a long and eventful history culminating in dismissal of a writ of error in 256 U. S. 125, 41 S. Ct. 402, 65 L. Ed. 856 (1921).

<sup>21</sup> *Heimberger v. The Elliott Frog & Switch Co.*, 245 Ill. 448, 92 N. E. 297 (1910); *Stephan v. Lake Shore & M. S. Ry. Co.*, 106 Ill. App. 13 (1903).

<sup>22</sup> 204 Ill. App. 493 (1917).

<sup>23</sup> In *Fitzpatrick v. Pitcairn*, 371 Ill. 203, 20 N. E. (2d) 280 (1939), and *Friend v. Alton Ry. Co.*, 283 Ill. App. 366 (1936), for example, the filing of an amended complaint more than one year after the cause of action arose has been held insufficient to sustain a wrongful death case begun in apt time, the amendment having been denied retroactive operation. See also *Bishop v. Chicago Ry. Co.*, 303 Ill. 273, 135 N. E. 439 (1922), and *Corlin v. Peerless Gas Co.*, 283 Ill. 142, 119 N. E. 66 (1918).

LANDLORD AND TENANT—TERMS FOR YEARS—WHETHER RENEWAL CLAUSE IN LEASE GIVING TENANT RIGHT TO EXTEND TERM BUT SPECIFYING THAT RENT FOR EXTENDED TERM SHOULD BE SUBJECT TO AGREEMENT OF PARTIES WILL SUPPORT SPECIFIC PERFORMANCE AT A REASONABLE RENTAL—The question of whether a court of equity should grant specific performance at the request of a tenant, of an option to renew and extend a lease was the issue in the recent Ohio case of *Moss v. Olson*.<sup>1</sup> The option there involved fixed a definite term for the renewal period but left the rental to be paid "to be subject to agreement between the parties" at the time of renewal. The complaint alleged due notice of an intention to exercise the option and also a request made on the defendant to enter into negotiations for the purpose of agreeing upon the rental. It charged that defendant refused so to negotiate but instead served the lessees with a notice of termination of tenancy. Plaintiffs also alleged that they had spent large sums in preparing the demised premises for use by them as a food market; that such sums for improvements would not have been expended if the lessor had not granted the option contained in the lease; that plaintiffs were without adequate remedy at law, hence prayed the court to fix a reasonable rent and to specifically enforce the option. Defendant's general demurrer was sustained by the lower court on the ground that the option was void for uncertainty and indefiniteness and the suit was dismissed. The Ohio Court of Appeals affirmed that holding, but, on appeal to the Supreme Court, the latter reversed and ordered specific performance, directing the trial court to fix a reasonable rental for the renewal period.

As in the case of contracts generally, an option or covenant for renewal must be founded on a consideration,<sup>2</sup> but there is general agreement on the point that an option or covenant to renew a lease, when contained in the lease itself, is based on a sufficient consideration, even if unilateral in the sense that the lessee is under no obligation to renew,<sup>3</sup> because such a covenant may well be considered as a material inducement to the execution of the lease. Like any other mutual contract, however, the option must be definite and certain in its terms in order to be enforceable;<sup>4</sup> certain and definite both as to the duration of the renewal period and the rent to be paid.<sup>5</sup>

<sup>1</sup> — Ohio St. —, 76 N. E. (2d) 875 (1947). Weygandt, Ch. J., wrote a dissenting opinion.

<sup>2</sup> *Fienberg v. Adelman*, 260 Mass. 143, 156 N. E. 896 (1927).

<sup>3</sup> *Fuchs v. Peterson*, 315 Ill. 370, 146 N. E. 556 (1925).

<sup>4</sup> *Giglio v. Saia*, 140 Miss. 769, 106 So. 513 (1926); *Swedish-American Nat'l Bank v. Merz*, 179 N. Y. S. 600 (1919); *Moran v. Wellington*, 101 Misc. 594, 167 N. Y. S. 465 (1917). The same rule is applied to an option to purchase the demised premises: *Hayes v. O'Brien*, 149 Ill. 403, 37 N. E. 73 (1894).

<sup>5</sup> *Levin v. Munk*, 97 Ind. App. 118, 169 N. E. 82 (1929); *Baurman v. Binzen*, 16 N. Y. S. 342 (1891). But see *Metcalf Auto Co. v. Norton*, 119 Me. 103, 109 A. 384

A renewal covenant in a lease which leaves the amount of rental to be determined under some future agreement between the parties would generally be regarded as unenforceable and void for uncertainty and indefiniteness<sup>6</sup> by any court arbitrarily applying a strict view to the subject. But the cases in point can be classified into two categories: first, those in which the renewal provision makes no reference to the term and rental yet the court might find an inference, from such omission, that the rental and term were to be the same as that fixed in the original lease;<sup>7</sup> and second, those where the rental for the renewal period is obviously not to be the same as controlled the original lease but is to be made the basis of future ascertainment. The validity and enforceability of the latter will depend upon whether or not sufficiently definite standards are set up by which to determine the new rental.<sup>8</sup>

The option in the instant case clearly fell outside the first class for there was evidence from its terms that a straight renewal was not within the contemplation of the parties. Tested by the second category, it lacked both standards and machinery by which the new rental could be determined unless it was possible to find a tacit understanding that the future rental was to be a reasonable one if the parties themselves could arrive at no agreement as to the amount. In the absence of such an understanding, the court would clearly be guilty of rewriting a contract for the parties and then specifically enforcing it as so rewritten.<sup>9</sup>

As support for its decision that the option contemplated a reasonable renewal rental, the court cited decisions from other jurisdictions but an examination thereof reveals that most of them are not in point and are easily distinguishable from the issue presented by the instant case. They

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(1920), where the lease provided "with privilege on part of lessee to release at end of term for a term of years to be agreed upon at same rental." The lessee elected to renew for two years and the court sustained that action on the ground that "a term of years" meant not less than two years.

<sup>6</sup> *Vartabedian v. Peerless Wrench Co.*, 46 R. I. 472, 129 A. 239 (1925).

<sup>7</sup> A simple covenant to renew which makes no provision as to the terms and conditions of the renewal implies a renewal for the same rental, terms and conditions as provided in the original lease, hence is sufficiently definite, according to *Kean v. Story & Clark Piano Co.*, 121 Minn. 198, 140 N. W. 1031 (1913); 58-59 *Realty Corp. v. Park Central Valet*, 252 App. Div. 72, 297 N. Y. S. 40 (1937); *Tracy v. Albany Exch. Co.*, 7 N. Y. 472, 57 Am. Dec. 538 (1852).

<sup>8</sup> For example, in *Duffield v. Whitlock*, 26 Wend. (N. Y.) 55 (1841), the lease contained a covenant that at expiration the "lessor should grant a new lease for twenty years upon such terms as he might think proper and as might be approved by lessee." Specific performance was denied on the ground that the covenant was too vague.

<sup>9</sup> A comparable problem concerning specific enforcement of an option to purchase the demised premises, where no price was fixed, was considered in *Shayeb v. Holland*, — Mass. —, 73 N. E. (2d) 731 (1947), noted in 26 *CHICAGO-KENT LAW REVIEW* 188.

involved options under which the rent was to be fixed by arbitrators;<sup>10</sup> or specifically provided that the rent was to be a reasonable sum;<sup>11</sup> was to be ascertained by what responsible parties would agree to give for the use of the premises;<sup>12</sup> or at what the rent would be worth at that time;<sup>13</sup> or provided that the parties should agree on a rental if possible but if not then that appraisers were to be appointed.<sup>14</sup> Clauses of this character sufficiently set up some method by which to determine the renewal rental or else clearly support the inference that a reasonable rent was intended. In the instant case, however, the parties expressly provided that the rent was to be "subject to agreement" between the parties; an expression capable of only one construction, *i.e.* the parties were to agree upon the rental, an expression of intention so unequivocal as to leave no room for any inference.

Only three cases cited would appear to substantiate the view taken by the Ohio court. In the first, that of *Rainwater v. Hobeika*,<sup>15</sup> the original lease provided for a five-year term but after the execution thereof the tenant procured an option for an additional five years "at a price to be agreed upon at that time." The option was sought because the tenant planned considerable remodelling at a cost twice the amount originally contemplated as well as the installation of expensive custom-made equipment and fixtures which would be practically worthless if removed. The lessor, about three months before the original lease expired, gave notice to vacate on the ground that the lessee had not communicated his intention to renew and the lessor had, therefore, leased the premises to another party. The court held that the fact of notice strongly indicated an intention on the part of the lessor not to bargain in good faith and, as the tenant had performed as planned, he would suffer serious financial loss unless the court enforced the option. In direct contrast, there was no charge of bad faith in the instant case, the renewal clause there involved was contained in the lease itself, and there was no special

<sup>10</sup> *Houston v. Barnett*, 90 Ore. 94, 175 P. 619 (1918); *Kaufman v. Liggett*, 209 Pa. 87, 58 A. 129, 67 L. R. A. 353 (1904). Courts are in general agreement that if the terms are to be fixed by arbitrators a court of equity, on refusal by one of the parties to arbitrate or if the arbitrators cannot agree, may determine what would be a fair and reasonable rental and thereafter enforce the option accordingly: *Citizens Bldg. of West Palm Beach v. Western Union Tele. Co.*, 120 F. (2d) 982 (1941); *Maas Bros. v. Weitzman*, 288 Mich. 625, 286 N. W. 104 (1939).

<sup>11</sup> *Edward v. Tobin*, 132 Ore. 38, 284 P. 562, 68 A. L. R. 152 (1930).

<sup>12</sup> *Arnot v. Alexander*, 44 Mo. 25, 100 Am. Dec. 252 (1869).

<sup>13</sup> *Bechman v. Taylor*, 80 Colo. 68, 248 P. 262 (1926).

<sup>14</sup> *Streicher v. Heimburge*, 205 Cal. 675, 272 P. 290 (1928). There is language in *Bird v. Couchois*, 214 Mich. 607, 183 N. W. 36 (1921), which would indicate that the court would be willing to imply a "reasonable" rent, if necessary, but that case did not deal with an option to renew but rather a determination of the amount of rent to be paid for the balance of the original term.

<sup>15</sup> 208 S. C. 433, 38 S. E. (2d) 495, 166 A. L. R. 1228 (1946).

equities in favor of the lessees beyond the fact that, after taking possession, they had invested substantial sums in improvements which had been made on the assumption of a binding option.

In the second case, that of *Young v. Nelson*,<sup>16</sup> the option was for an additional five years at such rental "as may then be agreed upon between the lessor and lessee." The court held that such a clause was specifically enforceable at a reasonable rental, even though it contained no provision for determining the amount of the future rent, on the ground that as the option was for the benefit of the lessee the covenant should be construed most strongly against the lessor. That court admitted that its holding was in a definite and distinct minority category but asserted that it was doing equity by carrying into operation what it claimed to be the intention of the parties. Courts generally desire to validate contracts wherever possible, but they should refuse to read terms and conditions into a contract which the parties themselves have failed to place therein even though it might seem equitable to do so.

The third case, that of *Hall v. Weatherford*,<sup>17</sup> provides even less reliable support for it was a suit brought to quiet title to certain premises which had been leased to the lessee by the husband alone. The original lease contained an option to renew for a like period at a price to be agreed upon or, if not, then to be fixed by the lessor at a figure at which he was willing to lease to other parties. The husband had, in fact, granted a renewal at an agreeable increased rental but the wife contended that, as Arizona, the state in question, was a community property jurisdiction, the original lease was void for lack of her signature as well as for uncertainty. The court decided for the lessee on the ground of estoppel by conduct but did adopt the reasoning of the case last above mentioned. By concluding that the renewal was completely executed, the court did not have to decide any issue as to uncertainty in the option, so that case provides little authority for the reasoning adopted in the instant case. It may be said, therefore, that the Ohio court has chosen to follow a view based on slender precedent and definitely one in the minority on this issue.

No Illinois court of review has passed on this precise issue to date but the decided cases definitely indicate that Illinois would be inclined to follow the majority rule. In *Sterenburg v. Beach*,<sup>18</sup> for example, it was

<sup>16</sup> 121 Wash. 285, 209 P. 515, 30 A. L. R. 568 (1922). In the earlier case of *Anderson v. Frye & Bruhn*, 69 Wash. 89, 124 P. 499 (1912), the lease contained an option for a two year renewal at a rental satisfactory to both lessor and lessee which the court said would be construed to mean a "reasonable" rental, but the language was dictum for the original lease was held invalid because not properly acknowledged.

<sup>17</sup> 32 Ariz. 370, 259 P. 282, 56 A. L. R. 903 (1927).

<sup>18</sup> 219 Ill. App. 68 (1920). The earlier Ohio case of *Braun v. Pociety*, 18 Ohio App. 370 (1923), is in accord with that holding.



held that the words "lease to be extended if both parties agree" were too vague and indefinite to constitute a valid covenant for renewal. Likewise, in *Streit v. Fay*,<sup>19</sup> the option did not fix the amount of rent to be paid under the renewal in terms of dollars but instead provided that the lessee might have the "privilege of five years longer by paying additional rent on revaluation now fixed at \$500." The court there concerned, finding no provision as to when and how the revaluation was to be determined, came to the conclusion that the option was also too indefinite and vague to support renewal. These cases point to the fact that courts ought not write contracts for otherwise competent parties and certainly cannot force them to agree. A provision which depends upon voluntary agreement for its effectiveness should be treated as unenforceable and void if that agreement is not forthcoming.

R. A. LEWIN

SEARCHES AND SEIZURES—UNREASONABLE SEARCHES AND SEIZURES—WHETHER OR NOT SEARCH WITHOUT WARRANT OF PERSON SITTING IN AUTOMOBILE IS JUSTIFIED AS AN INCIDENT TO SEARCH OF AUTOMOBILE FOR CONTRABAND—The recent United States Supreme Court decision in *United States v. DiRe*<sup>1</sup> presented a case in which an investigator of the Office of Price Administration, having been informed by one Reed that he was about to buy certain counterfeit gasoline ration coupons from one Buttitta, went with a municipal police detective to where Buttitta's car was parked and found the informer sitting on the rear seat of the car with two gasoline coupons in his hand. Upon interrogation by the officers, Reed declared that he had obtained the coupons from Buttitta, then sitting behind the wheel of the car. Alongside the driver sat DiRe, defendant in the instant case. The three occupants of the car were taken into custody, were subjected to a tentative search for weapons, and were then taken to a police station. DiRe was there directed to empty his pockets and, in compliance with such direction, laid out two gasoline and several fuel-oil ration coupons which he said he had found in the street. Some two hours later, after questioning, he was "booked" and a thorough search was then made of his person which disclosed a much larger number of counterfeit gasoline rationing coupons concealed between his shirt and underwear. The decisive evidence thus secured, obtained without a warrant of any kind, was later used to secure DiRe's conviction on a charge of knowingly possessing counterfeit gasoline ration coupons.<sup>2</sup> The

<sup>19</sup> 230 Ill. 319, 82 N. E. 648 (1907). See also *Pray v. Clark*, 113 Mass. 283 (1873).

<sup>1</sup> 332 U. S. 581, 68 S. Ct. 222, 92 L. Ed. (adv.) 218 (1948). Vinson, Ch. J., and Black, J., dissented.

<sup>2</sup> 50 U. S. C. App., Supp. V, § 633.

Circuit Court of Appeals for the Second Circuit, one judge dissenting, reversed on the ground that both the search and the arrest were illegal.<sup>3</sup> Upon certiorari, the prosecution contended the search was justified either as a proper incident to a lawful arrest or as an incident to the search of a vehicle reasonably believed to be carrying contraband. Despite this, a majority of the justices of the United States Supreme Court affirmed the reversal of the conviction, thereby providing an emphatic reassertion of the vitality of constitutional guarantees against unreasonable search and seizure which have lately been threatened with attenuation.

Parts of the majority opinion dealing with search as an incident to a lawful arrest and with aspects of conspiracy and waiver of constitutional guarantees merely reiterate well-defined legal principles. The holding on the claim that the search of DiRe's person was justified as an incident to search of a vehicle reasonably suspected to be carrying contraband, on the other hand, required consideration of a novel contention and led to a well-reasoned refutation thereof. Mr. Justice Jackson, speaking for the court, conceded that, since the decision in *Carroll v. United States*,<sup>4</sup> there has been an increasing tendency to believe that automobiles are more vulnerable to search without warrant than are other forms of property, but he ascribed the holding therein to the assumption by the court that it was applying the intent of Congress to facilitate the enforcement of the National Prohibition Act,<sup>5</sup> a measure subsequently repealed. He noted, however, that the decision "falls short of establishing a doctrine that, without such legislation, automobiles nonetheless are subject to search without warrant in the enforcement of all federal statutes."<sup>6</sup> The most that could be said of that case is that some of the language therein might be used to make a distinction between what would be a reasonable search when applied to an automobile in contrast to what would be proper if the search was of a residence or of other fixed premises.<sup>7</sup> Any doubt as

<sup>3</sup> 159 F. (2d) 818 (1947). Clark, J., wrote a dissenting opinion.

<sup>4</sup> 267 U. S. 132, 45 S. Ct. 280, 69 L. Ed. 543, 39 A. L. R. 790 (1925).

<sup>5</sup> U. S. C. A., Tit. 27, repealed Aug. 27, 1935, 49 Stat. 872.

<sup>6</sup> 332 U. S. 581 at 585, 68 S. Ct. 222 at 224, 92 L. Ed. (adv.) 218 at 222.

<sup>7</sup> Compare *Davis v. United States*, 328 U. S. 582, 66 S. Ct. 1256, 90 L. Ed. 1453 (1946), where the search of a business place for gasoline rationing coupons was upheld, absent a search warrant, on the ground the coupons were public property, with *Harris v. United States*, 331 U. S. 145, 67 S. Ct. 1098, 91 L. Ed. 1399 (1947), wherein an exhaustive search of residential quarters without warrant was treated as proper despite vigorous criticism from four of the justices. See also *Hart v. United States*, 162 F. (2d) 74 (1947). It is interesting to note that Justice Murphy, who dissented in the *Harris* case, quoted from the opinion of the Circuit Court of Appeals in the *DiRe* case, 159 F. (2d) 818 at 820, when he repeated the words of Learned Hand, J., to the effect that if "the prosecution of crime is to be conducted with so little regard for that protection which centuries of English law have given to the individual, we are indeed at the dawn of a new era; and much that we have deemed vital to our liberties, is a delusion." See 331 U. S. 145 at 195, 67 S. Ct. 1098

to the attitude of the federal courts on the subject should have been dispelled by the recent case of *Hart v. United States*<sup>8</sup> in which the court declared: "If we now sustain the search of one's automobile without inquiry into the validity of the search warrant, under authority of which the search was made, simply because probable cause existed for such a search, we will have gone a long way toward abdicating the idea that judicial sanction is a condition precedent to the authority. If probable cause is the only safeguard against unreasonable searches we have dispensed with the precautionary requirements of the warrant and limited the judicial function to a post mortem examination of probable cause. We have thus permitted the exceptions to consume the rule, and rendered impotent those safeguards, which in another day have been called 'the very essence of constitutional liberty and security.'"<sup>9</sup> It would seem, then, that the heyday of promiscuous searches of automobiles and their occupants is rapidly coming to an end.<sup>10</sup>

That issue was not actually decided for, as the court pointed out, no actual search of the automobile was made. The court was asked, however, to extend an assumed right to search the car to include the right to search the person of an occupant thereof on the theory that common sense demanded that such a right should exist in cases where the contraband sought was small in size and could readily be concealed on the person, an argument which had been given some point by the majority holding in the case of *Harris v. United States*.<sup>11</sup> In pointed fashion, that request was rejected on the ground that the relationship of the automobile to the crime of illegally transporting liquor in the *Carroll* case was an indispensable one whereas, in the instant case, it would take a violent stretch of the imagination to assume that a passenger would know what pieces of paper were concealed in the pockets of the driver.<sup>12</sup> No federal cases

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at 119, 91 L. Ed. 1399 at 1430. An appendix to the dissent in the *Davis* case tabulates the legislation on the point while a similar appendix to the *Harris* case provides a tabular analysis of all decisions since *Weeks v. United States*, 232 U. S. 383, 34 S. Ct. 341, 58 L. Ed. 632 (1914).

<sup>8</sup> 162 F. (2d) 74 (1947).

<sup>9</sup> 162 F. (2d) 74 at 76.

<sup>10</sup> See *State v. Miles*. — Wash. (2d) —, 190 P. (2d) 740 (1948), for example, where the court relied upon and quoted extensively from the decision in the instant case for support of the proposition that it was error to admit evidence seized from bystanders or taken from an automobile belonging to one of them parked near the scene of a crime for which crime they were not prosecuted but instead were tried for possessing the articles so seized.

<sup>11</sup> 331 U. S. 145, 67 S. Ct. 1098, 91 L. Ed. 1399 (1947), noted in 96 U. of Pa. L. Rev. 128, 33 Va. L. Rev. 646.

<sup>12</sup> The opinion in the instant case states: "We are not convinced that a person, by mere presence in a suspected car, loses immunities from search of his person to which he would otherwise be entitled." See 332 U. S. 581 at 587, 68 S. Ct. 222 at 225, 92 L. Ed. (adv.) 218 at 222.

were cited to support the holding declaring it improper to extend the scope of the search to include persons present at the time, but the case of *United States v. 1013 Crates of Empty Old Smuggler Whiskey Bottles*,<sup>13</sup> wherein a general search and seizure of everything contained in several warehouses and the indiscriminate arrest of several persons merely present at the time was held unreasonable, seems to support the view. There are also state cases in point. In *Jokosh v. State*,<sup>14</sup> for example, a warrant to search certain premises was held not to authorize a search of persons found therein and, according to *Purkey v. Maby*,<sup>15</sup> this is particularly true if the persons searched are not named in the affidavit upon which the search warrant issues.<sup>16</sup>

Viewed as a dry legal conclusion, the holding in the instant case superficially discloses a narrow refusal to extend a rule of law which was probably an unwarranted extension of fundamental principles to begin with. But it is difficult to read the opinion therein, or that in any decision on the question of search and seizure, without putting the immediate case against the background of man's halting struggle to attain a system of government which will be strong enough to protect him and yet against which his right as an individual to live with a minimum amount of governmental interference will prevail. Any conflict in the cases, whether caused by variance in the construction given to constitutional guarantees,<sup>17</sup> by attempts to view the issue from the standpoint of the officer, with his skill and knowledge, rather than that of the average citizen under similar circumstances,<sup>18</sup> or by a refusal to define what constitutes an unreasonable search except as required by the immediate case under examination, leaves the fundamental problem remain. Every decision on the subject, therefore, assumes an importance that cannot be overemphasized for it can carry connotations of tremendous significance. The holding in the instant case may rightfully be considered as a landmark one for it tends to insure to the individual a maximum of personal freedom which the holding in *Harris v. United States*<sup>19</sup> had subjected to jeopardy.

I. STEIN

<sup>13</sup> 52 F. (2d) 49 (1931).

<sup>14</sup> 181 Wis. 160, 193 N. W. 976 (1923).

<sup>15</sup> 33 Ida. 281, 193 P. 79 (1920).

<sup>16</sup> See also *Owens v. Way*, 141 Ga. 796, 82 S. E. 132, L. R. A. 1915E 399 (1914); *Newberry v. Carpenter*, 107 Mich. 567, 65 N. W. 530, 31 L. R. A. 163 (1895); *People v. Marxhausen*, 204 Mich. 559, 171 N. W. 557, 3 A. L. R. 1505 (1919), which contains an excellent dissertation on the historical background of the origin of search warrants; and *State v. Massle*, 95 W. Va. 233, 120 S. E. 514 (1923).

<sup>17</sup> In an official headnote to the decision in *McIntyre v. State*, 190 Ga. 872, 11 S. E. (2d) 5 (1940), appears the statement: "Under repeated decisions by this court, the admission in evidence in a State-court trial of articles taken from the defendant and his automobile by State officers without a search warrant would not violate [the sections] of the constitution of this State . . . prohibiting unreasonable searches and seizures and compulsory self-incrimination."

<sup>18</sup> See *United States v. Sebo*, 101 F. (2d) 889 (1939).

<sup>19</sup> 331 U. S. 145, 67 S. Ct. 1098, 91 L. Ed. 1399 (1947).

WORKMEN'S COMPENSATION—INSURANCE AND PUBLIC FUNDS—WHETHER OR NOT EMPLOYER WHO PAYS ADDITIONAL COMPENSATION TO ILLEGALLY EMPLOYED MINOR MAY SECURE REIMBURSEMENT FROM INSURANCE CARRIER—The plaintiffs in the case of *Carmack v. Great American Indemnity Company*<sup>1</sup> were proprietors of a retail grocery market operating under the Illinois Workmen's Compensation Act and had an illegally employed minor working for them.<sup>2</sup> This minor employee sustained an accidental injury which arose out of and in the course of his employment and, in direct consequence thereof, he died. The deceased's mother, because of her dependency and the circumstances of his employment,<sup>3</sup> became entitled to additional compensation<sup>4</sup> which the plaintiffs paid under a lump-sum settlement by which they specifically reserved their right to claim reimbursement from their insurance carrier for the added compensation so paid. The plaintiffs then sued the insurance carrier claiming to be entitled to reimbursement under paragraph I(a) of the standard form of workmen's compensation insurance policy, pursuant to which the insurer expressly agreed with the employer to pay promptly to any person, entitled thereto under the workmen's compensation laws, the entire amount of any sum due. The plaintiffs also relied on Section 26(a)(3) of the Illinois act<sup>5</sup> which provides that the employer's insurance policy must insure his entire liability to pay compensation awards and further directs that any provision in the policy attempting to limit or modify the liability of the insurer shall be wholly void. The defendant, on the other hand, contended that if the plaintiff was to recover at all it had to be on paragraph I(b) of the standard policy which grants indemnity only against the claims of those who are legally employed, hence the additional benefits paid by reason of the illegal employment constituted a penalty for which the employer was alone liable. In affirming a judgment in favor of the plaintiffs in the lower court, the Illinois Appellate Court for the Third District held that as the provision for additional compensation was distinct from the penal provisions of the Child Labor Law<sup>6</sup> the additional assessment was not to be regarded as a penalty against the employer so was included in the policy coverage. A certificate of importance was granted for appeal to the Illinois Supreme Court and it affirmed the holding for the plaintiff.

<sup>1</sup> 400 Ill. 93, 78 N. E. (2d) 507 (1948), affirming 332 Ill. App. 354, 75 N. E. (2d) 521 (1947).

<sup>2</sup> The employee had been hired in violation of Ill. Rev. Stat. 1947, Ch. 48, § 31.9, in that no working certificate, as required thereby, had been obtained.

<sup>3</sup> Ill. Rev. Stat. 1947, Ch. 48, § 144(c).

<sup>4</sup> *Ibid.*, § 144(i).

<sup>5</sup> *Ibid.*, § 163(a)(3).

<sup>6</sup> *Ibid.*, § 17 et seq.

The Illinois Workmen's Compensation Act and most other statutes are silent on the character to be attached to the additional award due an illegally employed minor, but Section 14-a(2) of the New York statute<sup>7</sup> declares that the additional sum is to be regarded as a liability imposed upon the employer alone<sup>8</sup> and Florida,<sup>9</sup> New Jersey,<sup>10</sup> Pennsylvania<sup>11</sup> and Utah<sup>12</sup> have incorporated similar provisions in their statutes. The Wisconsin statute, in contrast, while basically in accord with the New York view in that the employer is made liable for the increased compensation payable to illegally employed minors, directs that the insurer is to be held secondarily liable,<sup>13</sup> thereby providing an added security to the injured employee in case his employer should turn out to be insolvent.

Illustrative of the operation of these statutes is the New York case of *Bogartz v. Astor*<sup>14</sup> which interprets the language of the section referred to above. The plaintiff there, a minor, had been illegally employed by the defendant<sup>15</sup> and through the defendant's negligence he was injured. The employer's insurance carrier paid the normal workmen's compensation award to the minor. Subsequently a further sum equal to the amount of the award was paid by the employer to the minor pursuant to Section 14-a(2). Thereafter the minor sought and was granted a recovery of his damages from the defendant in a third-party action relying on the contention that the additional payment under the statute was a penalty against the employer for employing a minor in violation of the Child Labor Law. The upper court in reversing held that the extra payment required by that statute was not a mere pecuniary punishment or penalty but was to be treated the same as any other monetary benefit secured by the compensation law. As a consequence the injured employee was held obliged to make full restoration of the total award received by him in

<sup>7</sup> Cahill's Cons. Laws N. Y. 1930, Ch. 66, § 14-a(2).

<sup>8</sup> It also directs that any provision in an insurance policy designed to relieve the employer from such increased liability shall be void.

<sup>9</sup> Fla. Stat. Ann. 1943, § 440.54.

<sup>10</sup> N. J. Stat. Ann. 1940, § 34:15-10. See also *Damato v. DeLucia*, 10 N. J. Misc. 308, 159 A. 526 (1932).

<sup>11</sup> *Purdon Pa. Stats. Ann.*, Tit. 77, § 672, interpreted in *McGuckin v. Keystone Dye & Metal Works*, 29 Pa. D. & C. 556 (1937), and in *Lucia v. Capitol Pants Co.*, 29 Pa. D. & C. 590 (1937).

<sup>12</sup> Utah Code Ann. 1943, Vol. III, Tit. 42, § 42-1-57.10, applied in *Ortega v. Salt Lake Wet Wash Laundry*, 108 Utah 1, 156 P. (2d) 885 (1945).

<sup>13</sup> Wis. Stat. 1943, Ch. 102, § 102.62.

<sup>14</sup> 293 N. Y. 563, 59 N. E. (2d) 246 (1944).

<sup>15</sup> The employee there, as in the instant case, had been hired in violation of Cahill's Cons. Laws N. Y. 1930, Ch. 32, § 131(1), in that no working certificate had been obtained.

the event he should be made whole thereafter by recovery from a third party for the same injury.<sup>16</sup> In the event nothing was recovered, however, it would seem that the employer would be unable to shift the burden of the additional sum so paid to any other person but would be forced to bear the same himself.

The decision in the instant case, although one of first impression in Illinois, does not stand alone for there are two other decisions which uphold the views expressed therein. In the Michigan case of *Stuart v. Spencer Coal Company*<sup>17</sup> and in the California case of *Massachusetts Bonding & Insurance Company v. Industrial Accident Commission*<sup>18</sup> it was held that the insurer was liable for the additional compensation by reason of the terms of the contract with the employer. In each instance the obligation to pay the entire amount of the award was said to rest on the language contained in paragraph I(a) of the standard policy, despite the employer's illegal conduct in hiring a minor. The absence of designation in the statute that the additional compensation is a penalty to be borne by the employer alone would seem to be the controlling and distinguishing feature.

The admitted purpose of workmen's compensation laws is to promote general welfare by providing compensation for accidental injuries or death suffered in the course of employment. Similarly, the purpose of requiring the employer to carry insurance is one to secure the employee against being forced to bear the loss which would be produced in the event of the inability of the employer to pay. But it would seem reasonable that some further provision should be made to discourage employers from illegally employing minors, in addition to the penal provisions of child labor laws. Illinois, while assuring the illegally employed minor payment

<sup>16</sup> Accord: *Inland Steel Company v. Fries*, 114 Ind. App. 119, 49 N. E. (2d) 382 (1943); *Wynkoop v. Superior Coal Co.*, 116 Ind. App. 237, 63 N. E. (2d) 305 (1945); *Damato v. DeLucia*, 10 N. J. Misc. 308, 159 A. 526 (1932); *Sackolwitz v. Charles Hamburg & Co., Inc.*, 295 N. Y. 264, 67 N. E. (2d) 152 (1946); *Molina v. B. D. Kaplan & Co.*, 44 N. Y. S. (2d) 662 (1943), affirmed in 293 N. Y. 700, 56 N. E. (2d) 586 (1944); *Moreno v. Halstead Canning Co., Inc.*, 258 App. Div. 829, 15 N. Y. S. (2d) 765 (1939); *McGuckin v. Keystone Dye & Metal Works*, 29 Pa. D. & C. 556 (1937); *Lucia v. Capitol Pants Co.*, 29 Pa. D. & C. 590 (1937). If the employee elects to qualify for additional compensation under the statute he may, according to *In re Dearborn Manufacturing Co.*, 18 F. Supp. 763 (1937), reversed on other grounds in 92 F. (2d) 417 (1937), and *Ortega v. Salt Lake Wet Wash Laundry*, 108 Utah 1, 156 P. (2d) 885 (1945), be precluded from maintaining a civil action for damages.

<sup>17</sup> 307 Mich. 685, 12 N. W. (2d) 443 (1943). In giving judgment for the employer, the court stated that the additional compensation, although payable because of the illegal employment, was not a penalty against the employer but that the insurance carrier must pay the entire award as it had contracted to do.

<sup>18</sup> 19 Cal. App. (2d) 583, 65 P. (2d) 1349 (1937). The court found that the policy expressed in the act itself required the employer to secure payment of all compensation to persons entitled thereto and held the insurance carrier liable for the full amount, basing its decision squarely upon the carrier's agreement embodied in paragraph I(a) of the standard policy.

of his award by making the insurer liable, does nothing to deter the employer from entering into illegal contracts for hire when it permits him to shift the loss to others. The New York view tends to discourage illegal employment by making the employer solely liable but at the potential expense of the minor employee if the employer should turn out to be insolvent. The Wisconsin statute, on the other hand, not only discourages illegal employment by making the employer liable but, by making the insurer secondarily liable, guarantees the employee complete compensation. It, therefore, seems to carry out most fairly the underlying objectives and design of workmen's compensation laws.

H. G. BATES

WORKMEN'S COMPENSATION—PROCEEDINGS TO SECURE COMPENSATION—WHETHER OR NOT INJURED MINOR EMPLOYEE IS REQUIRED TO GIVE NOTICE OF INJURY WITHIN TIME PRESCRIBED BY WORKMEN'S COMPENSATION ACT—The minor employee involved in the recent case of *Ferguson v. Industrial Commission*<sup>1</sup> sustained what appeared to be an insignificant injury in the course of his employment so no immediate report thereof was made to the employer. The minor's condition became worse, however, and required hospitalization some twenty-six days later. Although a guardian had been appointed for the minor's estate about a year prior to the injury he had no knowledge of the accident until the thirty-day period fixed by statute for the giving of notice had expired<sup>2</sup> but promptly on learning of the facts he then notified the employer and began proceedings to recover compensation. The claim was denied by the arbitrator for failure to give prompt notice and that holding was affirmed by both the commission and the circuit court. On writ of error obtained by the guardian, the Illinois Supreme Court also affirmed despite the contention that the minor claimant, being under a legal disability, was entitled to the benefit of certain savings provisions, modified in 1927, which exempted "mental incompetents" from the requirement of compliance with what would otherwise be a jurisdictional element of the statute.<sup>3</sup> The court pointed out that minors were, for this purpose, to be considered the same as adult employees,<sup>4</sup> particularly if capable of legal representation through a duly constituted guardian.

<sup>1</sup> 397 Ill. 348, 74 N. E. (2d) 539 (1947).

<sup>2</sup> Ill. Rev. Stat. 1947, Ch. 48, § 161, requires that the notice be given within thirty days after the accident.

<sup>3</sup> Laws 1927, p. 513; Ill. Rev. Stat. 1947, Ch. 48, §§ 145(h) and 161.

<sup>4</sup> The term "employee," according to Ill. Rev. Stat. 1947, Ch. 48, § 142, includes minors who are, for the purpose of that statute, to be "considered the same and have the same power to contract, receive payments and give quittances therefor as adult employees."



It has been noted that "probably no question connected with workmen's compensation law is more novel . . . than the question of the status of minor employees under such law, and . . . that there is no fixed rule or principle of decision established, but that the question is one of the construction of statutes which vary materially in different jurisdictions."<sup>5</sup> The writer of that statement might have noted that the problem is complicated even more because of changes made from time to time in the statutes in any given jurisdiction, but there is, nevertheless, some unity of intent expressed by both courts and legislatures for the direct protection of minors.<sup>6</sup> Some statutes, for example, expressly direct that limitation periods contained in workmen's compensation laws are not to apply to minors until after the appointment of a legal representative.<sup>7</sup> Others extend that saving provision to mental incompetents and to minor dependents without representation.<sup>8</sup> Only a small minority direct that the minor employee shall stand, for all purposes, in the same relation to the workmen's compensation laws as do adults.<sup>9</sup>

Illinois law has now, for the first time, been established by the instant decision, but it was not always in that condition and, judging by prior cases, was not such as would lead to the expectation that the holding therein would normally be produced. In *Walgreen Company v. Industrial Commission*,<sup>10</sup> for example, no claim was made on behalf of the minor employee until four years after the injury. The statute then provided that if the injured employee should be "incompetent" at the time of the injury any time limitations imposed should not run "so long as said incompetent employee is without a conservator or guardian."<sup>11</sup>

<sup>5</sup> See opinion of Commissioner Hickman, in *Latcholia v. Texas Employer's Insurance Association*, 140 Tex. 231 at 235, 167 S. W. (2d) 164 at 166 (1942).

<sup>6</sup> Schneider, *Workmen's Compensation Text* (Thomas Law Book Co., St. Louis, Mo., 1945), Perm. Ed., Vol. 4, p. 197.

<sup>7</sup> Ark. Laws 1939, p. 777, § 18(c); Cal. Deering Code, Labor, Part 4, Ch. 2, § 5408; Ida. Code Anno. 1932, Ch. 12, § 43-1206; Ind. Burns Stat. Ann. 1933, § 40-1413; Kan. Gen. Stats. 1935, Ch. 44, § 509; Ky. Rev. Stats. 1946, § 342.210; Me. Rev. Stats. 1944, Vol. 1, Ch. 26, § 23; Mo. Rev. Stats. Anno. 1939, Vol. 11, Ch. 29, § 3727; Mont. Rev. Code 1935, Ch. 256, § 2900; N. J. Rev. Stats. 1937, Vol. 2, Ch. 34:15, § 51; N. Y. Baldwin Cons. Laws 1938, Vol. 7, Work. Comp. Law, Art. 7, § 115; N. Car. Gen. Stats. 1943, Vol. 2, Ch. 97, § 50; S. Car. Code 1942, § 7035-52; Vernon's Tex. Civ. Stats. Anno., Art. 8306, § 13; Va. Code Anno. 1942, Ch. 76A, § 1887(50); Wyo. Comp. Stats. Anno. 1945, Vol. 4, § 72-107.

<sup>8</sup> Okla. Stats. 1941, Tit. 85, § 106; Vt. Pub. Laws 1933, Tit. 30, § 6540.

<sup>9</sup> Ala. Code 1940, Tit. 26, § 296; Ariz. Code Anno. 1939, Ch. 56, § 56-974; Colo. Stats. Anno. 1937, Ch. 97, § 288(b); Minn. Anno. Stats. 1941, Vol. 13, § 176-18.

<sup>10</sup> 323 Ill. 194, 153 N. E. 831, 48 A. L. R. 1199 (1926).

<sup>11</sup> Laws 1919, p. 544, then provided: "In case an injured employee shall be incompetent at the time when any right or privilege accrues to him under the provisions of this Act, a conservator or guardian may be appointed, pursuant to law, and may, on behalf of such incompetent, claim and exercise any such right or privilege with the same force and effect as if the employee himself had been competent and had claimed or exercised said right or privilege; and no limitations of time by this Act provided shall run so long as said incompetent employee is without a conservator or guardian."

On the strength thereof, an award of compensation was affirmed, the court reaching the conclusion that the "incompetent" person referred to necessarily included a minor for another provision dealt with those who suffered from mental incapacity.<sup>12</sup> In still another case, that of *Waechter v. Industrial Commission*,<sup>13</sup> the court permitted a minor dependent to recover death benefits over three years after the death of his parent, the employee, by pointing out that the provisions of the workmen's compensation statute, which purported to treat minors as possessing the same power to contract, receive payments and give quittance thereof as would adults,<sup>14</sup> were to be confined to minor employees and were not applicable to minor dependents. Even more striking was the holding in *Oran v. Kraft-Phenix Cheese Corporation*<sup>15</sup> wherein the minor employee was allowed to conduct a common-law action against the employer even though he had not filed a rejection of benefits within the six-month period fixed by law,<sup>16</sup> especially since the minor himself had no legal power to make a binding declaration and had no legal guardian at the time.<sup>17</sup> The conclusion would, therefore, seem to be that, up to the present, there has been a pronounced legislative and judicial policy in this state to protect the rights of minors.

Support for the decision in the instant case, however, was said to rest in the fact that, subsequent to the decision in the Walgreen case, the legislature amended the statute, in essence, by prefixing the word "mental" before the word "incapacity" in the section which had been construed in that case<sup>18</sup> and by adding certain other provisions with respect to mental incapacity.<sup>19</sup> These amendments, at first blush, would logically make it appear that the several periods of limitation should run against an injured minor employee, unless he was also a mental incompetent, for while minors are "incompetent" in a strict legal sense they are not usually classified as being "mental incompetents," for that term is usually applied to idiots, lunatics or insane persons. Such at least has been the

<sup>12</sup> That section is presently found in Ill. Rev. Stat. 1947, Ch. 48, § 145(h).

<sup>13</sup> 367 Ill. 256, 11 N. E. (2d) 378 (1937), followed and approved in *Skaggs v. Industrial Commission*, 371 Ill. 535, 21 N. E. (2d) 731 (1939).

<sup>14</sup> Ill. Rev. Stat. 1947, Ch. 48, § 142.

<sup>15</sup> 324 Ill. App. 463, 58 N. E. (2d) 731 (1944), noted in 23 CHICAGO-KENT LAW REVIEW 355. See also *Kijowski v. Times Publishing Corp.*, 298 Ill. App. 236, 18 N. E. (2d) 754 (1939), affirmed in 372 Ill. 311, 23 N. E. (2d) 703 (1939).

<sup>16</sup> Ill. Rev. Stat. 1947, Ch. 48, § 143.

<sup>17</sup> Much the same view has been reached with respect to suits on behalf of minors against municipal corporations: *McDonald v. Spring Valley*, 285 Ill. 52, 120 N. E. 476, 2 A. L. R. 1359 (1918). Accord: *Murphy v. Village of Ft. Edward*, 213 N. Y. 397, 107 N. E. 716 (1915).

<sup>18</sup> Laws 1927, p. 517.

<sup>19</sup> *Ibid.*, p. 501.

holding in a number of other states possessing substantially similar laws,<sup>20</sup> but there are decisions to the contrary<sup>21</sup> and one case even goes so far as to excuse non-compliance with the statute where the minor had a general guardian at the time of the injury.<sup>22</sup>

It would seem, then, that much will depend upon the attitude brought to bear on the problem. As the Illinois court seems bent to give strict adherence to the express word of the statute, notwithstanding that it marks a deviation from what had previously been an established policy in favor of minors, the instant decision is worthy of more than passing notice.

R. A. LEWIN

<sup>20</sup> *Royal Indemnity Company v. Agnew*, 66 Ga. App. 377, 18 S. E. (2d) 57 (1941); *Porter v. Liberty Mut. Ins. Co.*, 46 Ga. App. 86, 166 S. E. 675 (1932); *Williams v. Cities Service Gas Co.*, 151 Kan. 497, 99 P. (2d) 822 (1940); *Brenn v. City of St. John*, 149 Kan. 416, 87 P. (2d) 546 (1939); *Suttle v. Marble Produce Co.*, 140 Kan. 13, 34 P. (2d) 116 (1934); *Mallory v. Ward Baking Co.*, 270 Mich. 91, 258 N. W. 414 (1935); *Bankers Trust Co. v. Tatti*, 258 Mich. 357, 242 N. W. 777 (1932); *Gelewski v. Cudile*, 17 N. J. Misc. 49, 4 A. (2d) 9 (1939); *Westrick v. Industrial Commission*, 50 Ohio App. 234, 197 N. E. 823 (1935); *Indian Territory Illum. Oil Co. v. Crown*, 158 Okla. 51, 12 P. (2d) 689 (1932); *Skelly Oil Co. v. Johnson*, 157 Okla. 278, 12 P. (2d) 177 (1932); *Edge v. Dunean Mills*, 202 S. C. 189, 24 S. E. (2d) 268 (1943); *Franse v. Knox Porcelain Corp.*, 171 Tenn. 49, 100 S. W. (2d) 647 (1937).

<sup>21</sup> *Walsh v. Flour City Ornamental Iron Co.*, 157 Minn. 396, 196 N. W. 486 (1923); *Lineberry v. Town of Mebane*, 219 N. C. 257, 13 S. E. (2d) 429, 142 A. L. R. 1033 (1941); *Latcholia v. Texas Employers' Ins. Ass'n*, 140 Tex. 231, 167 S. W. (2d) 164 (1942).

<sup>22</sup> In *Dulin v. Industrial Accident Commission*, 65 Cal. App. (2d) 89, 149 P. (2d) 868 (1944), the court held that the provision tolling the limitation period "until a trustee or guardian is appointed" was to be read with the provision authorizing the industrial commission to appoint some one to represent the minor employee and did not contemplate representation by a general guardian.